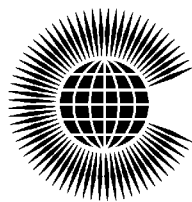


Commonwealth Secretariat



Commonwealth Finance Ministers Meeting

St Lucia, 6-8 October 2008

FMM(08)(INF)6

PROGRESS REPORT ON THE COMMONWEALTH SECRETARIAT PROJECT - PROFILING ECONOMIC VULNERABILITY AND RESILIENCE IN SMALL STATES¹

Paper for the Commonwealth Secretariat
(for the information of delegates)

Commonwealth Secretariat
Marlborough House
London SW1Y 5HX

September 2008

¹ Paper prepared by Lino Briguglio, Gordon Cordina, Nadia Farrugia and Stephanie Vella of the Economics Department, University of Malta in consultation with the Governments of St Lucia and Seychelles. The views expressed do not necessarily represent the position of the Commonwealth Secretariat or member Governments of the Commonwealth.

(BLANK PAGE)

CONTENTS

INTRODUCTION	1
SECTION I - CONCEPTUAL UNDERPINNINGS OF MEASURING ECONOMIC VULNERABILITY AND RESILIENCE	
<i>The Measurement of Economic Vulnerability</i>	3
<i>Four Country Scenarios</i>	5
<i>Measuring Economic Resilience</i>	6
<i>A Country-Based Approach</i>	7
<i>Assessing the Symptoms of Economic Vulnerability or Lack of Resilience</i>	9
<i>Assessing the Causes of Economic Vulnerability</i>	10
<i>Assessing the Sources of Economic Resilience</i>	12
SECTION II - PROFILE OF VULNERABILITY AND RESILIENCE IN SEYCHELLES	17
<i>An Assessment of the Manifestations of Economic Vulnerability</i>	18
<i>An Assessment of the Causes of Economic Vulnerability</i>	21
<i>An Assessment of the Sources of Economic Resilience</i>	23
<i>Macroeconomic Stability</i>	23
<i>Microeconomic Market Efficiency</i>	25
<i>Political Governance</i>	26
<i>Social Development</i>	26
<i>Environmental Management</i>	27
<i>Policy Implications and Conclusions</i>	27
SECTION III - PROFILE OF VULNERABILITY AND RESILIENCE IN ST LUCIA	29
<i>An Assessment of the Symptoms of Economic Vulnerability</i>	31
<i>An Assessment of the Causes of Economic Vulnerability</i>	33
<i>An Assessment of the Sources of Economic Resilience</i>	35
<i>Macroeconomic Stability</i>	36
<i>Microeconomic Market Efficiency</i>	37
<i>Political Governance</i>	38
<i>Social Development</i>	38
<i>Environmental Management</i>	39
<i>Policy Implications and Conclusions</i>	39
References.....	41
Statistical Sources.....	42
APPENDIX 1: The Final Statement – St Lucia.....	43
APPENDIX 2: The Final Statement – Seychelles.....	46

Figures and Tables

Figure 1: The Four Scenarios.....	5
Figure 2: Risks Associated with Being Adversely Affected by External Shocks	6
Table 1: The Symptoms of Vulnerability	9
Table 2: The Causes of Vulnerability	11
Table 3: The Sources of Resilience	12
Table 4: The Seychelles – Key Indicators	18
Table 5: Saint Lucia – Key Indicators	30

INTRODUCTION

The paper presents a progress report on the Commonwealth Secretariat pilot project to profile economic vulnerability and resilience in Small States. The aim of this project is to enable small states to assess their economic resilience and identify gaps and best practices within their resilience framework. This project builds on the work done by the University of Malta in collaboration with the Commonwealth Secretariat during 2004 to 2007 on the economic resilience index and the economic resilience framework. There has also been the publication of three books² as a result of this work.

2. This project report is presented in three sections – Section I examines the concepts of vulnerability and resilience whilst Sections II and III present the vulnerability and resilience profiles of Seychelles and St. Lucia respectively, together with the policy implications that may be derived from these assessments. The vulnerability and resilience profiles of these two countries were compiled following a two-day consultation conference in each country and a survey conducted with relevant country institutions.³

3. The next step within this **stage of the vulnerability and resilience profiling** would consist of a similar profiling exercise in a Pacific country. The **next two stages** in this pilot project will involve the **identification of specific projects** that will assist small states to build their resilience and **technical assistance to ensure the implementation of these projects**.

² The names of the books are: *Small States and the Pillars of Economic Resilience* (2008); *Building the Economic Resilience of Small States* (2006); and *Economic Vulnerability and Resilience of Small States* (2004)

³ The final statement issued by participants at the end of these two consultation conferences are reproduced in the Appendix to this paper.

(BLANK PAGE)

SECTION I - CONCEPTUAL UNDERPINNINGS OF MEASURING ECONOMIC VULNERABILITY AND RESILIENCE

The Measurement of Economic Vulnerability

4. Small economies tend to face higher levels of risks to their economic growth and development engendered by their exposure to shocks and/or by their inherent characteristics. This phenomenon was studied through several approaches aimed at constructing vulnerability indices. These mainly focused on quantifying the special characteristics of small states using indicators such as economic openness, export concentration, dependence on imports of energy and peripherality. Cordina (2008) categorises the approaches to vulnerability measurement into those which focus on the *causes* of the phenomenon and those which attempt to measure vulnerability in terms of its *effects*, namely the variability of output and similar indicators.

5. The first vulnerability index, which focused on the causes of the phenomenon, was developed by Briguglio (1992; 1995) and was composed of three variables, namely: exposure to foreign economic conditions; insularity and remoteness; and proneness to natural disasters. These variables were suitably normalized and averaged. It was hypothesised that the higher the incidence of these variables in a given country, the higher the degree of vulnerability in the same country, everything else, including GDP per capita, remaining constant. The hypothesis that Small Island Developing States (SIDS) tend to be more vulnerable than other countries was confirmed since in general SIDS registered higher vulnerability scores than other groups of countries.

6. Chander (1996) employed a methodology similar to that used by Briguglio (1992) with a number of technical refinements, and showed that in general, small states had larger vulnerability scores than larger countries. Chander (1996) emphasised the fact that countries with a diversified export and production base were less vulnerable. Several important technical modifications to the original approach were effected in Briguglio (1995, 1997), including the omission of the natural disasters variables so as to enhance the focus on economic sources of vulnerability. The results did not alter the basic conclusions regarding the vulnerability of SIDS.

7. Crowards (2000) confirmed the results of previous studies through a methodology which was similar to earlier approaches, but introduced some technical improvements. Briguglio and Galea (2003) continued to refine the measurement of economic vulnerability by considering dependence on food imports and export concentration in services. On similar lines, Cordina and Farrugia (2005) argued that vulnerability ensues if a country is significantly exposed to trade with other countries which are themselves unstable, or in commodities with prices which are highly volatile.

8. Wells (1997) used a different approach by focusing on the effects of vulnerability, as manifested in income volatility and used regression analysis to identify the causes of vulnerability. He hypothesized that economic volatility, used as a proxy for economic vulnerability is related to three variables, namely: export diversification; the resource gap in relation to GDP; and the proportion of the population affected by natural disasters. This approach did not require the normalization of the variables, and the regression coefficients were taken as the weights of the variables. Output volatility was also used for the index developed by Atkins et al. (2000), who based their approach on Wells (1997) using three

explanatory variables namely: export dependency ratio; merchandise export diversification; and vulnerability to natural disasters

9. The Committee for Development Policy (CDP) of the United Nations adopted a rather different approach in constructing an economic vulnerability index, which they utilized to assess graduation of countries out of the LDC status (United Nations, 2006). The index combines inherent features and manifestations of vulnerability relating to the following variables: population size, remoteness, merchandise export concentration, share of agriculture, forestry and fisheries in gross domestic product, homelessness owing to natural disasters, instability of agricultural production and instability of exports of goods and services.

10. Cordina (2008) used regression analysis to synthesise the conclusions of the various approaches towards measuring economic vulnerability. The study finds strong support for the hypothesis that vulnerability is higher for small countries, while the hypothesis that vulnerability is heightened for island states is also supported but somewhat less strongly. He argued that the variables which mostly capture inherent economic vulnerability are economic openness, export concentration and dependence on strategic imports.

11. Economic openness as measured by the ratio of international trade to GDP, proxies the extent of external shocks over which a country has no direct control. Economic openness is to a significant extent an inherent feature of an economy, conditioned mainly by the size of the country's domestic market and by the country's availability of resources which affects its ability to efficiently produce the range of goods and services required to satisfy its aggregate demand. While it may be argued that openness to international trade may be influenced by policy and is therefore not a vulnerability issue (see Guillaumont, 2006), practical experience shows that trade policies tend to influence more the composition of a country's external trade flows rather than the degree of economic openness. Furthermore, while openness to international trade could be a source of development for a country, this does not detract from the fact that by participating more actively in international trade, a country would be exposing itself to a larger degree of shocks over which it has relatively little control.

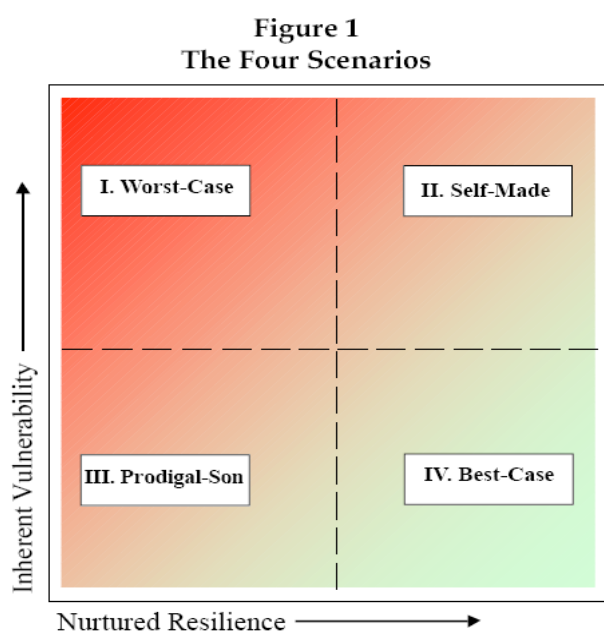
12. Export concentration is relevant for vulnerability measurement because dependence on a narrow range of exports gives rise to risks associated with lack of diversification, and therefore exacerbates the vulnerability associated with economic openness. This condition is to a large extent the result of inherent features in the production base of an economy. Export concentration can be measured by the UNCTAD index of merchandise trade (UNCTAD, 2003: section 8). Briguglio (1997) and Briguglio and Galea (2003) devised an alternative index which also takes services into account.

13. Dependence on strategic imports is another facet of the exposure argument, focusing on shocks to the availability and costs of such imports. This variable can be measured as the ratio of the imports of energy, food or industrial supplies to total imports or to GDP. This condition is to a large extent inherent in that it depends on country size, resource endowments and possibilities for import substitution.

Four Country Scenarios

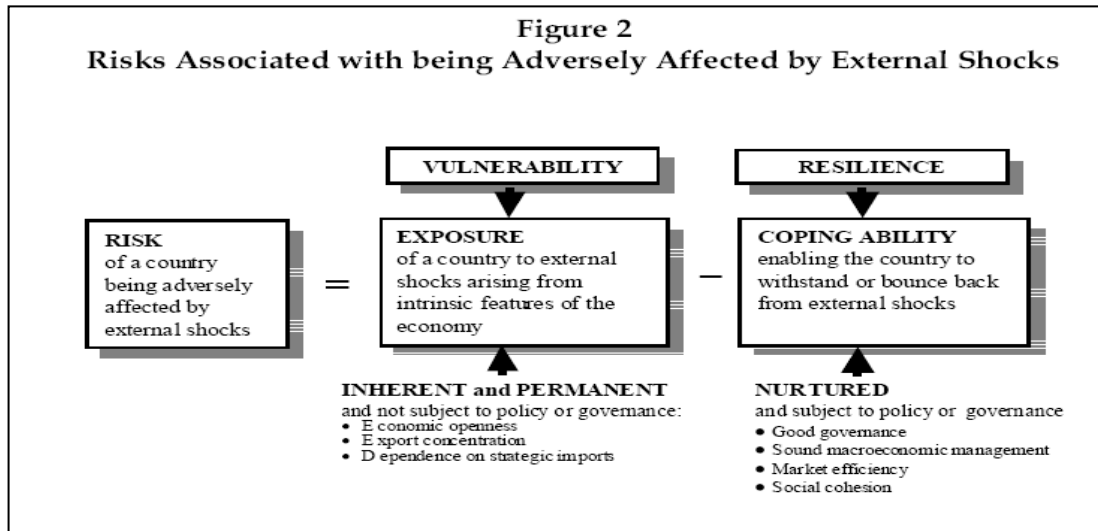
14. Briguglio et al (2006) define economic resilience as the policy-induced ability of an economy to recover from or adjust to the negative impacts of adverse exogenous shocks. They propose this as an explanation as to why many small economically vulnerable states generate a relatively high GDP per capita. The authors explain this in terms of the juxtaposition of economic vulnerability and economic resilience, identifying four possible scenarios into which countries may be placed according to their vulnerability and resilience characteristics. These scenarios are termed as “self made”, “prodigal son”, “best case” and “worst case”. Countries classified as “self made” are those which are inherently highly economically vulnerable but at the same time have built their economic resilience through the adoption of appropriate policies that enable them to cope with or withstand the effects of their inherent vulnerability. Countries falling within the “prodigal son” category are those with a relatively low degree of inherent economic vulnerability but whose policies are deleterious to economic resilience, thereby exposing them to the adverse effects of shocks. The “best case” category applies to countries that are not inherently vulnerable and which are relatively well governed economically. Conversely, the “worst case” category refers to countries that compound the adverse effects of inherently high vulnerability by adopting policies that run counter to economic resilience.

15. This classification is shown in Figure 1, which indicates that economically vulnerable countries, which are well economically governed and have therefore built their economic resilience, are likely to fall in quadrant II.



Reproduced from Briguglio (2006)

16. Another feature of this approach is that it shows that the risk of being harmed by exogenous shocks has two elements, the first is associated with the inherent conditions of the country that is exposed to external shocks and the second associated with policies which enable an economy to absorb, cope with or bounce back from adverse shocks. The risk of being adversely affected by the shock is therefore the combination of the two elements (see Figure 2).



Measuring Economic Resilience

17. A framework for the measurement of economic resilience has been developed by Briguglio et al (2006) who constructed a resilience index based on the following factors:

- macroeconomic stability;
- microeconomic market efficiency;
- good governance; and
- social development.

18. Macroeconomic stability is related to economic resilience in that if an adverse economic shock hits the economy when it is already in a weak position, there will not be much room for manoeuvre, and therefore fiscal and monetary policies might not be effective in mobilising resources so as to enable the economy to rebound from the effects of such a shock. In other words sound macroeconomic policies create latitude for monetary and fiscal policy to respond to shocks (Jayaraman, 2006). Briguglio et al. (2006) propose to measure the macroeconomic stability aspect of resilience on the basis of three variables, 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. The choice of these was based on their relevance to the resilience concept as well as on the fact that comparable data is available for a wide range of countries.

19. Microeconomic market efficiency is required for an economy to withstand the effects of negative shocks by enabling a country to rapidly reallocate resources to alternative uses. Briguglio et al. (2006) use, as a proxy for market efficiency, a segment of the *Economic Freedom of the World Index* (Gwartney and Lawson, 2005) entitled “regulation of credit, labour and business”, which is aimed at measuring the extent to which markets operate freely, competitively and efficiently across countries. It is designed to identify the effects of regulatory restraints and bureaucratic procedures on competition and the operation of markets. This index focuses on the efficiency of the financial and labour markets, as well as on the degree of bureaucratic control on business.

20. Good governance is an essential underpinning to appropriate policy formulation and hence an indispensable element of economic resilience, spanning over issues including the

rule of law, property rights, domestic and international security and the adequate participation in international trading frameworks. In the absence of good governance, it would be easy for adverse shocks to result in economic and social chaos and unrest. Hence the effects of vulnerability would be exacerbated. In order to derive a proxy variable for good governance, Briguglio et al. (2006) use a component of the *Economic Freedom of the World Index* which focuses on legal structure and security of property rights. This index focuses on judicial independence, impartiality of courts, the protection of intellectual property rights, military interference in the rule of law and the integrity of the political and legal systems.

21. Social development is another essential component of economic resilience. This factor indicates the extent to which relations within a society are properly developed, enabling an effective functioning of the economic apparatus without the hindrance of civil unrest. Social development can also be related to social cohesion and as such indicates the extent to which effective social dialogue takes place in an economy, which would in turn enable collaborative approaches towards the undertaking of corrective measures in the face of adverse shocks. Briguglio et al. (2006) measure social development by using the education and health indicators within the UNDP Human Development Index (HDI).

22. Briguglio et al. (2006) juxtaposed their economic resilience index with the Briguglio and Galea (2003) vulnerability index and concluded that, with reference to Figure 1 above:

- countries which fall in the “best-case” quadrant are mostly the large developed countries including Western Europe;
- countries which fall in the “self-made” quadrant include a number of small states with a high vulnerability score;
- countries which fall in the “prodigal-son” quadrant include mostly large third world countries; and
- countries which fall in the “worst-case” quadrant include a few vulnerable small countries with weak economic performance.

A Country-Based Approach

23. Studies on economic vulnerability and resilience undertaken so far focus on a cross-sectional approach, aimed at benchmarking countries within a global context. As such, they are useful mainly for three purposes. One is to disseminate information on and drawing attention to the issues of vulnerability and resilience building because an index is a very good instrument for drawing attention to the issue being investigated. A second purpose is to help to develop a common language for discussion, because the derivation of indices requires quantification and hence, precise definitions of fundamental notions. The third is to promote the idea of integrated action because indices are the result of a combination of factors.

24. It is, however, also true that for the purposes of policy formulation and implementation, benchmarking within an international context is often merely a starting point which needs to be followed by more in-depth investigation of issues within the specific context of the country and its circumstances. It is here proposed that while the notions of economic vulnerability and resilience have been crucial towards promoting a better understanding of development issues of small states especially in relation to their success as compared to larger countries, their practical applicability within the context of policy-setting for an individual country must go beyond the limits of indices derived from internationally comparable data.

25. These limits pertain in part to restrictions in obtaining data for a sufficiently wide cross-section of countries, thereby curtailing the range of issues which can potentially be studied.

26. Another important limitation of cross-sectional approaches emanates from the fact that, in order to compare one country with another, a variable within an index may be considered redundant, and thereby omitted, if it is highly correlated with another that is already included in the index. While this is a valid action within a benchmarking study, it is not suitable for a study focusing on an individual country, where all aspects of vulnerability and resilience need to be studied, irrespective of whether they are correlated or otherwise.

27. Here we propose a conceptual approach aimed at building a template of variables to be considered in the derivation of a vulnerability/resilience profile for an individual country. The template builds on the findings of the literature up to date, and extends these concepts as may be appropriate for an individual country setting. The derivation of the economic vulnerability/resilience profile proposed here is based on three facets, as follows.

- *An assessment of the symptoms of economic vulnerability.* This facet relates to the manifestation of vulnerability or lack of resilience and attempts to determine whether a country appears to be suffering from any one or more of the symptoms of vulnerability or otherwise. This gives a first indication within the country profile, as to which areas of economic activity or policy may be conducive to economic vulnerability
- *An assessment of the causes of economic vulnerability.* This facet of the profile relates to the underlying causes of vulnerability and is aimed at assessing the inherent fundamental conditions which may be rendering a country vulnerable to exogenous shocks.
- *An assessment of the sources of economic resilience.* This facet of the profile aims to highlight the strengths and weaknesses within the policy formulation milieu of a country towards the objective of economic resilience building.

28. Each of these assessment facets can be carried out through quantitative variables. In cases where quantitative variables are not available or insufficiently representative of the important issues under consideration, qualitative data can be used, which could then be expressed through a mapping scale of a number possibilities.

29. Tables 1 to 3 below present a number of variables which could be used for the purpose of country profiling. The variables and factors have been selected on the criteria of relevance and parsimony, in such a way that they are comprehensive of all important issues to be discussed without being excessively cumbersome for the purposes of analysis. The quantitative variables are typically available from a statistical system that corresponds with the Generalised Data Dissemination Standard of the International Monetary Fund, although the requirements for the approach proposed here are less stringent than that of the Standard. The qualitative factors are to be obtained from case-study approaches within the individual country, backed by relevant data as may be available.

Assessing the Symptoms of Economic Vulnerability or Lack of Resilience

30. Economic vulnerability in countries where resilience is not sufficiently developed is often manifested in four phenomena, as identified by Cordina (2008). These are:

- volatility in output and consumption over time;
- volatility in the value and volume of international transactions;
- volatility in exchange rates and prices, and
- sustained deficits on the external current account deficit and high government expenditure.

31. These variables proposed to measure them are summarized in Table1.

Table 1: The Symptoms of Vulnerability*

Volatility in output and consumption	GDP at current prices per capita, in domestic currency
	GDP at constant prices per capita, in domestic currency
	Consumption expenditure per capita at current prices, in domestic currency
	Consumption expenditure per capita at constant prices, in domestic currency,
Volatility in value and volume of international transactions	Exports of goods and services at current prices, in domestic currency
	Exports of goods and services at constant prices, in domestic currency
	Imports of goods and services at current prices, in domestic currency
	Imports of goods and services at constant prices, in domestic currency
Volatility in exchange rates and prices	Nominal effective exchange rate: highest monthly average
	Nominal effective exchange rate: lowest monthly average
	Real effective exchange rate: highest monthly average
	Real effective exchange rate: lowest monthly average
Short-term shock absorbers	External current account balance as percent of GDP
	Government total expenditure as percent of GDP

*All variables are based on annual observations covering 10 years of most recent data

32. Volatility in output and consumption can be gauged by developments in the respective variables in per capita terms, at current and constant prices in index levels, for a period of time which is sufficiently long to enable the observation of volatility. A ten-year period would be appropriate in this case, as this could indicate the assessment of long term growth trends, cyclical fluctuations as well the effects of specific shocks and their aftermath. Likewise, the volatility in the value and volume of financial transactions can be discerned from the developments in imports and exports in index levels, at current and constant prices, over a sufficiently long period of time.

33. Depending on the type of exchange rate regime adopted, a country that is susceptible to external shocks may experience volatility in either the nominal or the real exchange rate. Volatility in either one or both of these variables, which can be as the maximum and minimum month values over a ten-year period, and this is considered to be a symptom of vulnerability to external shocks.

34. Economic vulnerability and/or insufficient resilience may also produce persistent deficits on the external current account of the balance of payments, a result of responses to shocks to strategic import prices and to specific demand shocks within a narrow range of exports (Cordina, 2008).

35. They may also result in relatively high levels of government expenditure, reflecting the need for stabilization interventions to manage the effects of shocks.

36. Consideration of these variables yields a generic indication regarding the extent to which a country is being affected by shocks, which is a combination of its inherent vulnerability and nurtured resilience. In order to derive meaningful comparisons, the numerical values of the variables considered may be analysed over time or in relation to another country or limited group of countries. This would be followed by an assessment of the specific causes of vulnerability and the sources of resilience, as explained in the following sections.

Assessing the Causes of Economic Vulnerability

37. From a conceptual viewpoint, the extent to which a country is subject to shocks is a function of two factors. The first is its inherent exposure to such shocks. Exposure on its own however does not imply that shocks of a significant nature would be influencing a country. For this to happen, exposure would have to be combined by the actual materialization of shocks, here termed the incidence of shocks. Table 2 details the variables which are proposed to be considered in order to measure a country's exposure to shocks and the extent of incidence of shocks to which a country may be exposed.

38. The degree of exposure to shocks may be measured by variables which are in common use within the vulnerability literature. These are trade openness, defined as the share of exports and imports within GDP, the degree of export market concentration, measured by the share within total exports of the three main export products/services and a measure of the price elasticity involved in international trade transactions. The notion behind the last factor is that if a country is engaged in price inelastic exports and price inelastic imports, negative shocks to the terms of trade would imply significant welfare losses to the economy. Thus, it is proposed that the price elasticity of international trade transactions be measured by the shares within the respective totals of commodity exports and of strategic imports, the latter defined to include food and energy.

39. The degree of incidence of shocks on an economy is here construed to depend upon three factors, namely the proneness to domestic demand shocks, to fluctuations in international demand and to terms of trade shocks. It is proposed that the proneness to domestic demand shocks can be evaluated by considering the volatility of gross fixed capital formation for a sufficiently long period of time, in terms of changes in the levels in index format. The choice of this variable is motivated by the fact that gross fixed capital formation

is often one of the components of aggregate demand that is most sensitive to changes in economic conditions, including domestic economic policy.

Table 2: The Causes of Vulnerability*

Exposure to shocks	Trade Openness	Exports as percent of GDP
		Imports as percent of GDP
	Export Concentration	Sum of three main categories of exports of merchandise at the 3-digit level, as percent of total merchandise exports
		Sum of three main categories of exports covering merchandise (3 digit level) and services (tourism and financial services) as percent of total exports of goods and services)
Price elasticity of international trade	Commodity exports as percent of total exports of merchandise	
	Share of strategic imports (food, fuel and industrial supplies) as percent of imports of merchandise	
Incidence of shocks	Domestic shocks	Gross fixed capital formation
	International demand	Foreign financial capital inflows as percent of GDP
		Average weighted GDP of three main partner countries, constant prices,
Terms of trade shocks	Export prices	
	Import prices	

*All variables are based on annual observations covering 10 years of most recent data

40. Shocks to international demand can be proxied by considering the volatility of foreign non-direct capital flows in relation to GDP, and through fluctuations in the average GDP in the three main trading partner countries. The choice of non-direct foreign investment flows is motivated by the fact that international capital flows are often a source of monetary volatility in a country with possible repercussions on the real economy. The exclusion of direct investment flows from this section of the analysis is based on the argument that such flows would be already incorporated in the gross fixed capital formation variable.

41. The GDP of the main trading partner countries is assumed to influence economic activity in the country being analysed, and relates to the causes of external shocks. The volatility in exports of the country in question in this framework is considered as a symptom rather than a cause of vulnerability, as explained in the previous section.

42. The obvious choice to the modelling of terms of trade shocks is export and import prices. The consideration of the movements of these separate variables over time gives an indication of the sources of shocks to economic activity emanating from changes in prices of strategic imports and of exports which often contribute substantially to incomes.

43. Thus, the joint consideration of factors which generate exposure to shocks and the extent of the shocks themselves would give a picture of the overall level of economic vulnerability of a country and the primary sources of such vulnerability. Combined with the information collected in the process of analysing the symptoms of vulnerability, a better understanding of the reasons behind and the effects of shocks on an economy would be obtained.

Assessing the Sources of Economic Resilience

44. Following the mainstream literature, economic resilience is here considered to depend upon policy interventions in five areas, namely macroeconomic robustness, microeconomic market efficiency, adequate governance, social development and environmental management. As discussed earlier on, the issue of environmental management is as yet not given explicit consideration in cross-country measures of vulnerability, although its importance is widely recognized. At a country level, the issue of environmental management should therefore receive attention.

45. An obvious difficulty in the measurement of resilience performance is that in practice, it is often very difficult to identify variables which measure the adequacy of policy interventions. Rather, the variables available would often be the result of policy interventions and other factors which enter into play in determining performance. For example, the inflation, unemployment, deficit and other variables used by Briguglio et al. (2006) would certainly reflect the quality of policy-making in a country, but not exclusively so. Thus, quantitative approaches towards the measurement of resilience must rely on proxy variables, which would not necessarily reflect solely policy issues. For this reason, the approach proposed here to evaluate the sources of resilience relies in good part on qualitative assessments based on case study approaches for an individual country.

46. Table 3 details the variables which are here proposed to be considered in the analysis of the sources of resilience of an individual country.

Table 3: The Sources of Resilience*

Macro- Economic	Gross fixed capital formation as percent of GDP
	Consumer price inflation (percent)
	Unemployment rate (as percent of GDP)
	Fiscal balance as percent of GDP
	Net external assets (external reserves less external debt) as percent of GDP
Micro- Economic	<i>Capital Mobility:</i>
	Exchange controls
	Interest rate control
	Quantitative controls (qualitative assessment over recent 3 years)
	<i>Labour Market Flexibility:</i>
	Skills mobility within the labour force
	Geographical mobility of labour (domestic and international)
	Government involvement in wage setting
	Union power
	<i>Product markets:</i>
	Government involvement in price setting (qualitative assessment over recent years)
	Level of domestic competition (qualitative assessment over recent years)
	Barriers to international trade (qualitative assessment over recent years)
	Participation in international trade arrangements/regional blocks (qualitative assessment over recent years)

Governance	Rule of law
	Security
	Property rights
	Institutional development
	Corruption
	Freedom of expression
	Human rights
	Participation in regional political and security arrangements
Social	Percentage of government budget assigned for social development (current and capital expenditures to be treated separately)
	Poverty/deprivation (measured by the percentage of the population living below the poverty line)
	Health (possibly measured by the number of hospital beds per capita and life expectancy)
	Education (possibly measured by school enrolment ratios, literacy rates and early school leaving rates)
	Income distribution
	Social cohesion (index could be based on variables related to ethnic fractionalisation, incidence of civil strife, prison population rate and suicide rates)
Environmental	Percentage of government budget assigned for environmental management (current and capital expenditures to be treated separately)
	Generation of waste per capita (solid and liquid to be treated separately. Sewage emissions into the oceans to be considered)
	Vehicles in use per square kilometre of populated land areas
	Carbon emissions per capita
	Percentage of land area designated as environmentally protected area
	Percentage of energy generated from renewable resources
	Number of international environmental instruments ratified and operationalised

*All data is to cover the five most recent years. Most variables, particularly those relating to microeconomic efficiency, governance and social aspects require a qualitative assessment of policy stances and major changes, accompanied, when available, by quantitative data.

47. Under the macroeconomic dimension, developments in price inflation, unemployment, the fiscal deficit as a percentage of GDP and net external assets as a percentage of GDP, are proposed to be considered, in line with the approach taken by Briguglio et al. (2006). In addition, developments in gross fixed capital formation as a percentage of GDP may be considered, because capital formation is often an essential element to resilience building within a country (Cordina, 2004a;b).

48. The role of the gross fixed capital formation variable within the context of this analysis deserves further consideration. Viewed in terms of levels over time, the volatility of gross fixed capital formation can be discerned, and this would constitute a cause of vulnerability, as discussed within the context of Table 2. Viewed as a proportion of GDP, where the effects of shocks would tend to be mitigated since capital formation and GDP would be likely affected in similar manner, gross fixed capital formation would indicate the extent to which an economy is building buffers which would enable it to meet the effects of shocks. From this perspective, therefore, the gross fixed capital formation variable would indicate a source of resilience.

49. The issue of microeconomic market efficiency within a country requires in-depth study which often goes beyond the information provided by international organisations. It is here proposed that this issue be investigated through a qualitative and case study approach specific to individual countries, backed by data and information that may be available.

50. The issues to be considered include the extent of capital mobility, as may be gauged by the presence of exchange controls, interest rate controls and quantitative controls on the financial system. The notion in this case is that frictions in the movement of capital within and outside the country would often constitute a barrier to the effective reallocation of resources following an external shock.

51. Similarly, labour market flexibility needs to be considered within this context. Issues which are relevant in this case would include the degree of skills present in the labour force, including the existence of multi-skilling, the geographical mobility of labour, at both domestic and international levels, as well as the extent of government interference in wage setting and of union power in the labour market. The latter two variables can be measured through, for example, the ratio of the average wage to the minimum wage and the level of union density, among other data-based and qualitative approaches.

52. As regards efficiency in product markets, the factors that need to be taken on board include the extent of government involvement in the price mechanism, which may be measured by the extent of price control. The level of domestic competition, as could be measured by market concentration ratios and the extent of barriers to international trade, as could be discerned by the average tariffs rates on imports, would also need to be investigated.

53. Finally, the extent of participation in international trading blocks, customs unions, single markets or monetary unions is to be measured in terms of the efficiencies that it would likely introduce within domestic markets. Data on this and other variables in the market efficiency group are not likely to be easily available. It is important to reiterate that within the individual country approach, quantitative data which cannot be obtained can be substituted by qualitative assessments based on case studies and expert opinion.

54. Governance issues may be also evaluated through quantitative and qualitative approaches according to the specific circumstances and needs of individual countries. At a conceptual level, the main issues to investigate in this case would include those studied by Kaufmann et al. (2006), including rule of law, security, the enforcement of property rights, institutional development, absence of corruption, freedom of expression and the safeguarding of human rights. In addition, the effects of participation in international political and security arrangements on the governance structures within a country could be investigated in this context, following Pace (2006).

55. A similar approach is proposed to be adopted in the investigation of social development issues within the context of resilience building. Government budget allocations for social development would seem to be relevant in this regard, although care should be taken to take account of expenditure inefficiencies. Following Springer (2006), the main factors which may be considered in this context include the extent of poverty and deprivation and the situation with regard to health, education, income distribution and social cohesion. Social empowerment requires strong fundamentals with respect to health, education and income status of the citizens and these variables should feature in the social development group of variables.

56. Specific issues relating to environmental management policies can be investigated through qualitative and quantitative approaches. The variables included in Table 3 were selected on the basis of their link with policy aimed at a more sustainable use of environmental resources. It is assumed that this should effectively improve the economic resilience of the economy.

(BLANK PAGE)

SECTION II – PROFILE OF VULNERABILITY AND RESILIENCE IN SEYCHELLES

57. The Seychelles comprise 115 islands located in the Western Indian Ocean with a population of approximately 85,000 persons. The country has a stable democracy and is member of various international organizations.⁴ Its economic development process is subject to the challenges usually faced by Small Island Developing States (SIDS) including resource limitations, peripherality from major markets and difficulties associated with international transport, geographical territorial dispersion including multiple insularity, limited ability to exploit economies of scale and to diversify economic activities, and vulnerability to external economic shocks and environmental impacts.

58. Table 4 details a number of key economic and social indicators for the Seychelles. The country had a per capita GDP of US\$10,733 in 2007, which the World Bank classifies as an upper-middle standard. Economic growth continued at a rapid pace during the year, at 5.1 per cent, sustained mainly by investment and export activity. These emanated mainly from activities in tourism and in the fisheries sector. These developments helped reduce the unemployment rate to 1.9 per cent, which was a historic low. Inflation was relatively high at 5.3 per cent during that year, reflecting a gradual depreciation of the local currency⁵ to correct for an overvalued rate being set historically and which resulted in an informal market for foreign currency within the country. This managed depreciation of the currency towards levels which are likely to be closer to equilibrium could also have been conducive to increasing the country's external competitiveness. International financial transactions are subject to exchange controls, which are being gradually dismantled.

59. Although a fiscal surplus was registered in 2007, this may be mainly due to cyclical rather than structural conditions of fiscal policy. The IMF (2008) considers fiscal policy to have been expansionary in 2007, as a result of higher-than-budgeted spending and lower revenues, but a significant primary surplus is being targeted for 2008. The country also experienced a widening current account deficit in 2007, but this in good part reflected capital expenditure. The IMF expects growth to ease somewhat in 2008, reflecting high international oil prices, an expected slowdown in global growth, and local capacity constraints. Inflation is likely to remain elevated in the short term, mainly due to one-off factors associated with currency realignment and the liberalization of administered prices.

60. The country is undergoing a range of structural reforms constituting a marked departure from the command-and-control style of economic policy implemented in recent decades. These include significant upward revisions of utility prices, removal of price controls on imports, and foreign exchange market liberalization measures. According to the IMF, the reforms will reduce subsidies to public enterprises, limit budgetary pressures, and improve market signals. The government's announcement that privatization will continue strengthens the prospects for private sector development.

⁴ including the Commonwealth, United Nations, IMF, World Bank, African Development Bank and COMESA.

⁵ the rupee, which is managed with a target rate of 8 rupees to 1 US dollar.

Table 4: The Seychelles - Key Indicators

Variable	Level	Period
GDP - total (US\$M)	911	2007
- per capita (US\$)	10,733	2007
- growth	5.1%	2007
Unemployment rate	1.9%	2007
Inflation rate	5.3%	2007
Fiscal balance (as a proportion of GDP)	1.1%	2007
Export sources:		
Tourism	55.4%	2007
Fisheries	41.7%	2007
Other	2.9%	2007
Life expectancy (years)	72.2	2006
Infant mortality (per thousand)	9.5	2006
Literacy rate	96.0%	2006

Source: Central Bank of Seychelles

61. From the perspective of social development, the Seychelles have a life expectancy at birth of 72.2 years, an infant mortality rate of 9.5 per thousand, and a literacy rate of 96 per cent. From the perspective of the Human Development Index, The Seychelles tend to rank around the 50th place in terms of social development variables, significantly behind the 40th ranking obtained for economic development measured in terms of GDP per capita.⁶ It thereby appears that economic achievements of recent years have not yet sufficiently percolated towards the ambit of social development.

62. In 2007, the Government of Seychelles launched the Strategy 2017 initiative⁷, which is aimed at doubling the country's GDP within a period of 10 years, by promoting the key economic sectors of tourism, fisheries and financial services, enhancing government efficiency, improving the functioning of the labour market, fostering private business and enhancing social structures. The Strategy also calls for the participation in regional trading blocks.

An Assessment of the Manifestations of Economic Vulnerability

63. During the decade to 2006⁸, the Seychelles experienced no effective increase in the real GDP, with the level in 2006 being practically unchanged from that in 1997. This was underpinned by an increase in real GDP of around 11 per cent between 1997 and 2000, followed by persistent drops through 2005, with a recovery in 2006 which appears to have been sustained in 2007 according to provisional data (see Chart 1). This indicates a significant exposure to the effects of vulnerability and lack of resilience during the period under consideration, which includes a slow and relatively volatile pattern of growth. The development of GDP at current prices has been more stable, but averaging at relatively low 2.5 per cent per annum, which may be wholly ascribed to increases in the prices of output.

⁶ http://hdrstats.undp.org/countries/country_fact_sheets/cty_fs_SYC.html accessed on 14 July 2008.

⁷ Republic of Seychelles (2007).

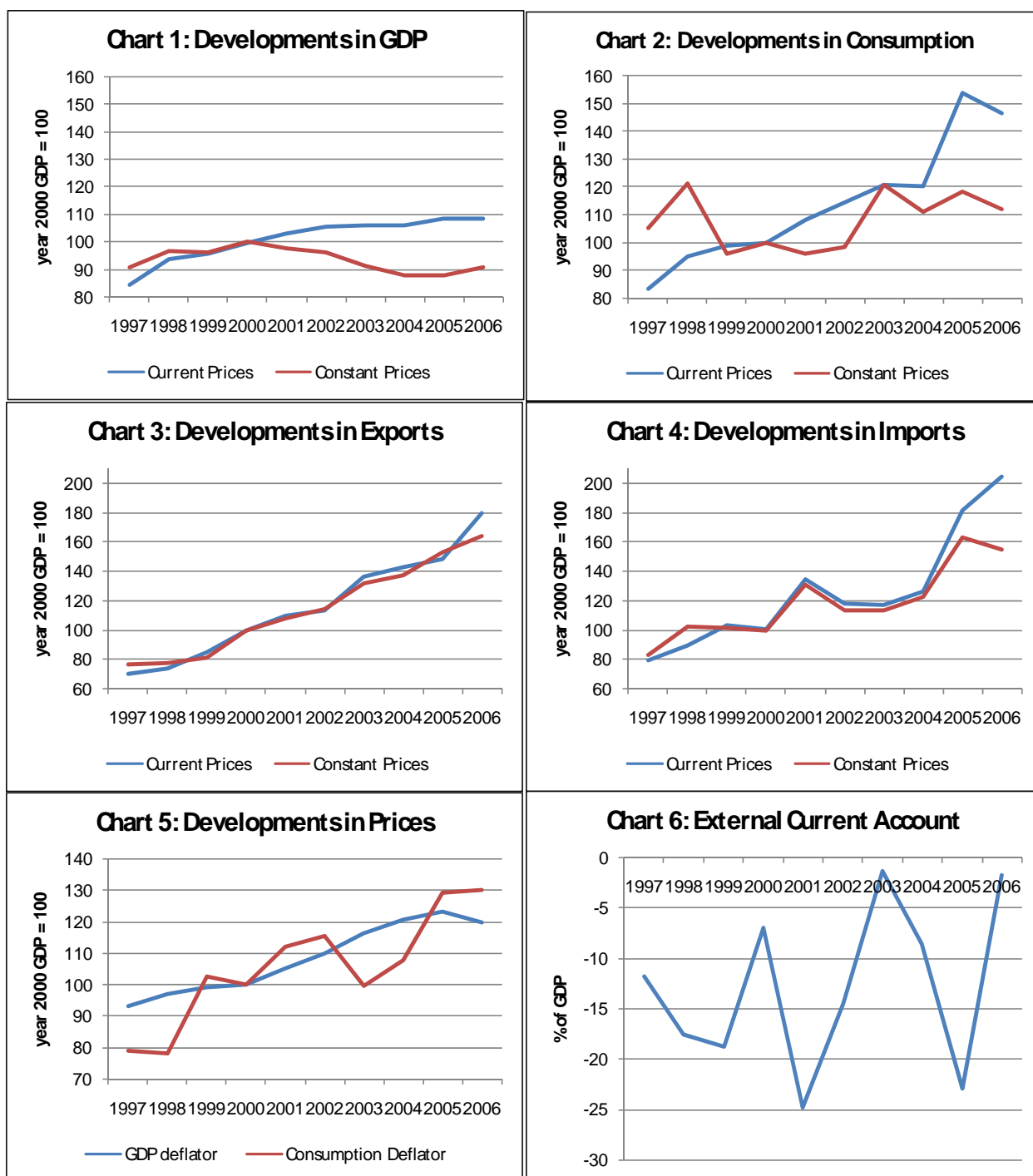
⁸ A complete and final dataset for the purposes of this analysis is available up to 2006. Reference to provisional data for 2007 is made where relevant.

64. Similar trends emerge from an analysis of private consumption expenditure, as shown in Chart 2. At constant prices, there was only a marginal progress in consumption, averaging a mere 0.6 per cent per annum. This was underpinned by a 9 per cent drop between 1997 and 2001, which was reversed in later years, and which followed a counter-cyclical trend with GDP. At current prices consumption grew at a rapid pace during the decade under consideration, averaging 5.8 per cent per annum. Nine-tenths of this growth was due to the effects of price inflation.

65. During the decade to 2007, the Seychelles experienced a sustained and stable rate of growth of exports, which averaged 9.8 per cent at both current and constant market prices (see Chart 3). This would seem to indicate that export volumes have increased, with average export prices remaining relatively stable. At current prices, imports have kept the pace with exports during the decade under review (see Chart 4), growing by almost 10 per cent per annum. At constant prices however, growth in imports was significantly more restrained, at 6.4 per cent per year. This indicates an adverse development in import prices which was not matched by an increase in the prices of exports.

66. While Briguglio et al. (2008) propose the consideration of the real and nominal effective exchange rates indexes as a measure of volatility to prices, these variables are not considered to be relevant in the analysis of the economy of the Seychelles, owing to the fact that the exchange rate was in recent years managed at an artificially high level and propped by exchange controls, which led to the proliferation of an informal market for foreign currency.

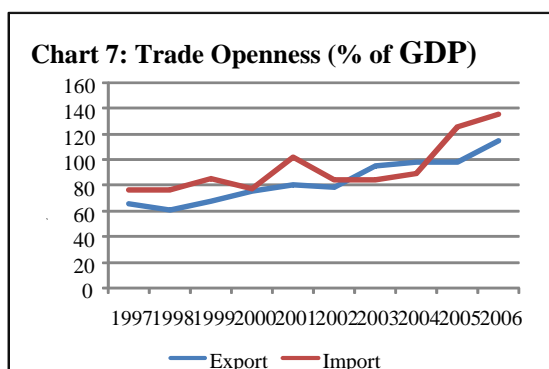
67. The symptoms of economic vulnerability are here assessed through developments in the deflators for GDP and for consumption expenditure, shown in Chart 5. The former rose at a stable pace during the decade to 2006, at an average rate of 2.5 per cent per year. The latter showed significant swings around an upward trend which averaged 5.2 per cent per year. Consumption prices thus grew at a significantly faster pace than the prices of the economy's output, partly a reflection of the trends in import and export prices discussed earlier on. This indicates restraints on the economy's consumption possibilities generated by its price taking behaviour in the international markets.



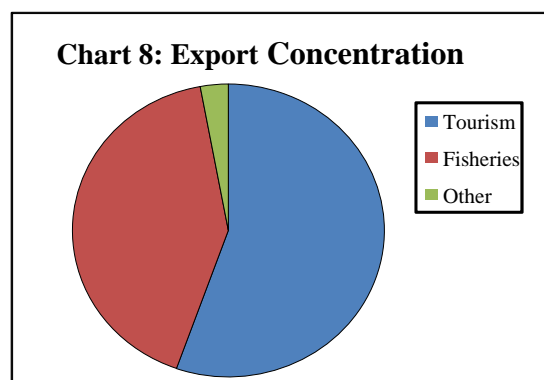
Source: World Bank,

68. The Seychelles experienced a consistently negative and volatile performance on its external current account during the decade to 2006, as shown in Chart 6. This indicates a high degree of susceptibility to external economic conditions, affecting especially the terms of trade as well as foreign direct investment into the country. It thus appears that the Seychelles has experienced a number of symptoms usually associated with economic vulnerability and lack of resilience during the decade to 2006. These were especially reflected in the low rate of real economic growth, adverse terms of trade developments which led to high inflation and reduced consumption possibilities, and a negative and volatile performance on the balance of payments. Data for 2006 and 2007 in general seems to point to a degree of recovery from these conditions, at least from the viewpoint of economic growth.

An Assessment of the Causes of Economic Vulnerability



Source: World Bank, UNCTAD



69. The next step in developing the economic vulnerability and resilience profile is to determine the causes of the vulnerability giving rise to these symptoms.

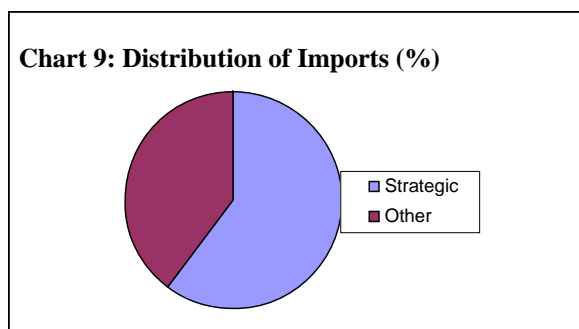
70. This facet of the profile relates to the underlying causes of vulnerability and is aimed at assessing the inherent fundamental conditions which may be rendering a country vulnerable to exogenous shocks. Charts 7 through 9 provide information on variables which proxy the exposure of the Seychelles to exogenous shocks.

71. Chart 7 indicates that both imports and exports are substantial when compared to the country's GDP and have been rising over time to levels well above 100 per cent. This is an indication of the fact that the economy is strongly influenced by developments in international markets. The risk of being affected by external shocks is even greater when the high degree of export concentration is taken into account. More than half of export receipts accrue from tourism, while over two-fifths originate from fisheries, as shown in Chart 8. Other activities account for less than 3 per cent of exports. This entails that shocks to the two main export revenue sources are bound to have profound effects on the economy.

72. It is to be further considered that fisheries essentially entail a commodity export, with the consequent implications for volatility in prices and demand. Likewise, tourism has a volatile demand, conditioned by factors such as international economic growth, environmental risks, domestic and international political developments,⁹ changes in the availability of transport facilities and business decisions of international tour operators.

73. On the import side, close to four-tenths of imports are made up of strategic commodities which are of the nature of necessities, including energy and food, as shown in Chart 9. This leaves the economy exposed to shocks in the international supply of these commodities, typically affecting their prices.

⁹ For example the terrorist attacks of September 11, 2001 affected tourism world-wide.

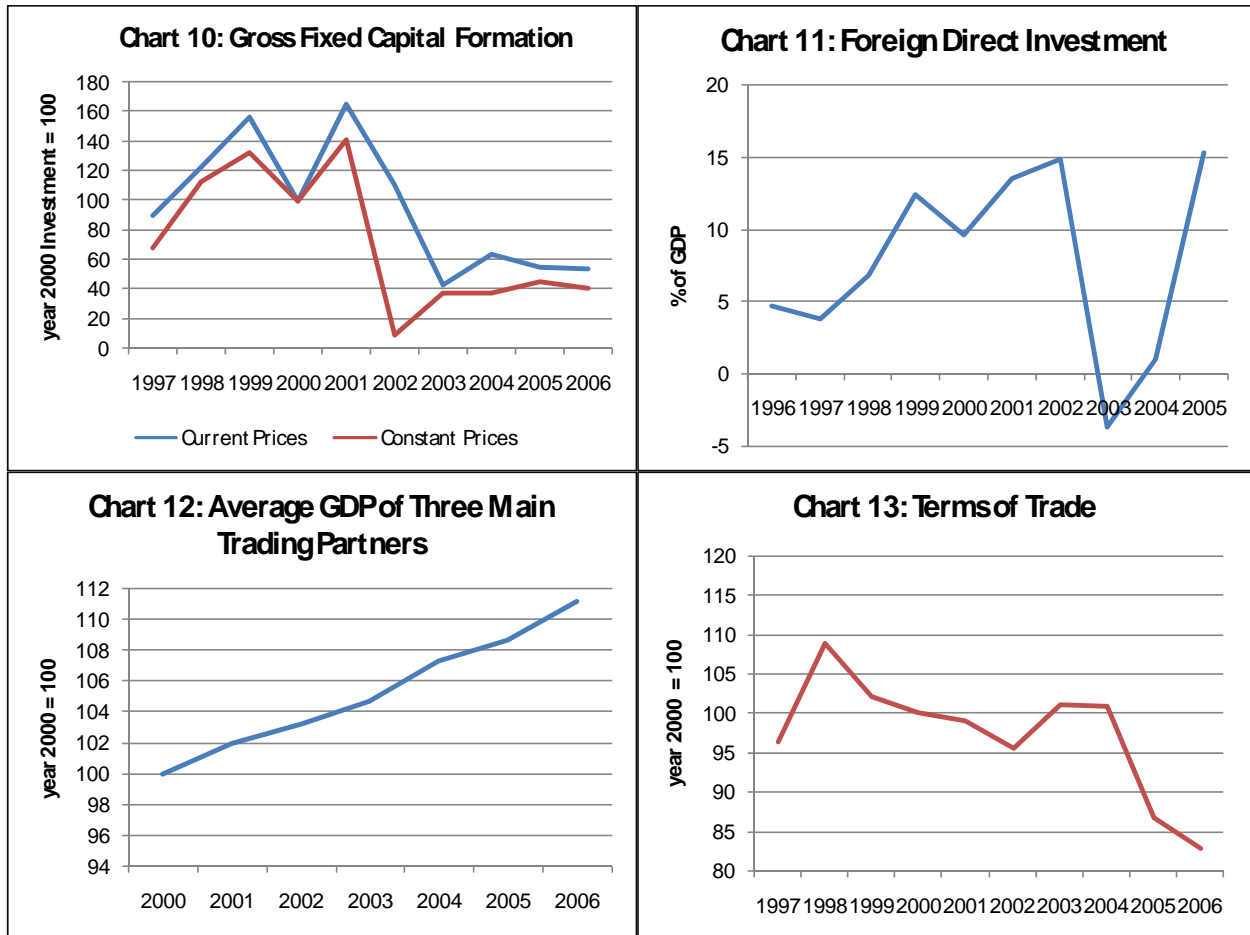


Source: World Bank, UNCTAD

74. This significant exposure to external shocks played a part in generating the symptoms of vulnerability identified in the preceding section, including the sluggish and volatile growth as well as the generally adverse and fluctuating performance on the external balance of payments. This, however, must also be viewed in terms of the incidence or extent of occurrence of the shocks to which the country is exposed. Charts 10 through 13 present an analysis of this factor.

75. Chart 10 shows the significant part played by fluctuations in gross fixed capital formation to economic development in the Seychelles. Over the past decade, gross fixed capital formation has fluctuated significantly, ending in 2006 at roughly half the level in the year 2000. This reflected changes to demand from the international sector, particularly with regard to the development of tourism infrastructure and has played an important part in the decline in real GDP experienced since the turn of the decade. The volatility in gross fixed capital formation in part reflects significant swings in foreign direct investment flows, which over a decade have fluctuated between -3 per cent to 15 per cent of GDP, as shown in Chart 11. Fluctuations in the overall levels of GDP of the three main trading partner countries, namely France, Italy and the United Kingdom, were not pronounced during the period (see Chart 12) and cannot be identified to have caused the symptoms of vulnerability which the Seychelles experienced. Indeed, the latter are probably more due to the commodity concentration in exports and imports and to the share which the latter occupy within total economic activity.

76. Furthermore, shocks to terms of trade have been significant and strongly adverse in the past decade, with the purchasing power of exports falling from a base of 100 in the year 2000 to 83 by 2006, as shown in Chart 13. This reflects the dependence on commodity and price-sensitive tourism exports coupled with the dependence on strategic imports undergoing significant price increases in the international markets.



Source: World Bank

77. Thus, it can be concluded that the symptoms of vulnerability which the Seychelles has experienced in the past decade are in part due to inherent structural features in the economy including its exposure to international business and commodity concentration, coupled with a strong incidence of shocks to gross fixed capital formation and to the external terms of trade. Countries facing these types of shocks can however be successful in overcoming their effects through appropriate resilience-building policies, the assessment of which is the next element in this profile.

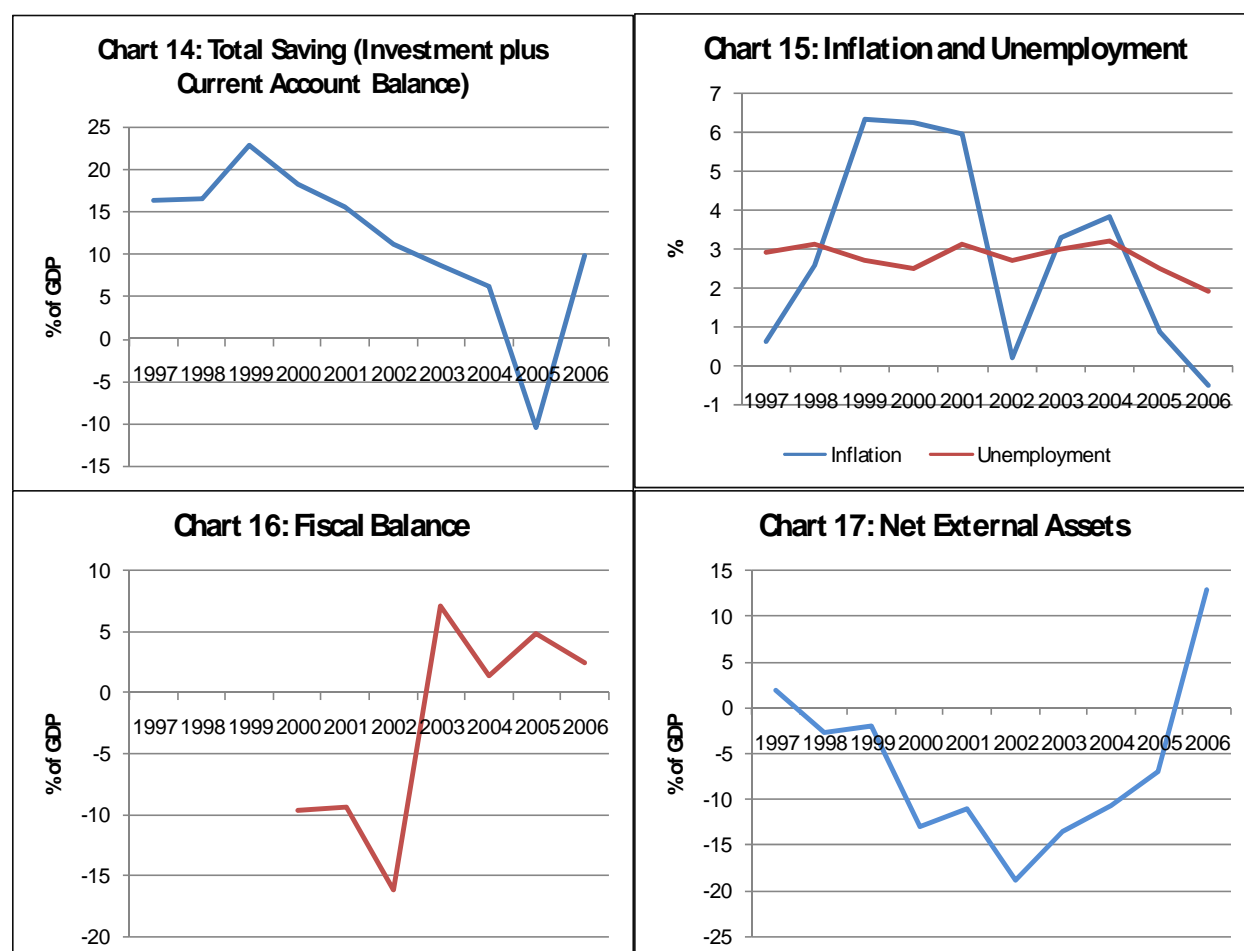
An Assessment of the Sources of Economic Resilience

78. This facet of the profile aims to highlight the strengths and weaknesses within the policy formulation milieu of a country towards the objective of economic resilience building. Economic resilience counteracts the effects of economic vulnerability by increasing the economy’s ability to cope with the adverse effects of exogenous shocks.

Macroeconomic Stability

79. Charts 14 through 17 present an analysis of the variables that are considered to proxy the extent to which macroeconomic policy is creating conditions that are conducive to the establishment of economic resilience. A fundamental requisite towards economic resilience is for a country to affect sufficient savings to create a buffer against potential shocks. As Chart 14 shows, the saving rate of the economy of the Seychelles fluctuated around a healthy 20 per cent of GDP between 1997 and 2001, but has since then slumped and it became negative in

2005 before settling at around 10 per cent in 2006. An insufficient level of saving is not sustainable in the medium term and could adversely impact on the economic resilience of the economy of the Seychelles.



Source: National Statistics Bureau – Seychelles, World Bank

80. Developments in inflation and unemployment are shown in Chart 15. It is important for these variables to be at low levels such that if adverse shocks should hit the economy, they would not further aggravate a serious situation. Inflation was relatively high albeit declining in the past decade, in spite of price controls and an overvalued exchange rate. As the economy is moving to a more free-market oriented system, short term inflationary pressures can be expected, compounded by developments in import prices. These factors contributed to an inflation rate exceeding 5 per cent in 2007.

81. The unemployment rate has gone down to a historic low of 1.9 per cent in 2007, mainly in response to a pick-up in economic activity. As Chart 15 shows, the unemployment rate tends to fluctuate around low and stable levels, which is however mainly an indication of insufficient supply of labour in the country, where the labour market participation rate out of the entire population is around 55 per cent. This is also evidenced by the significant number of expatriate workers, which amounted to almost 15 per cent of the labour force in 2007.

82. The fiscal balance moved from a persistent deficit right up to 2002 to consistent surpluses since 2003, as shown in Chart 16. This creates an important buffer of fiscal resources through which to meet the potentially adverse effects of shocks. With the economy's total saving being relatively low, however, it may be concluded that fiscal

consolidation may not be sufficient in this respect, and further headway needs to be made in order to restore macroeconomic balance. Indeed, a primary surplus of at least 5 per cent of GDP is needed in order to be able to meet annual loan servicing commitments. This is expected to be achieved in 2008. It is to be noted that fiscal policy discipline is being instilled, through measures including a cap on borrowing as determined by capital expenditure and the use of privatisation proceeds to reduce public debt.

83. The net external asset position gives another indication of the availability of buffer reserves from which to meet the effects of adverse shocks. Chart 17 shows that the net external asset position of the Seychelles was negative right through 2005, indicating a relatively strong reliance on foreign debt and a marked preference by Seychellois to hold their assets overseas, before moving into surplus in 2006. The volatility in this variable may however raise doubts regarding the ability of the economy to safeguard a positive level of net external assets.

Microeconomic Market Efficiency

84. Microeconomic market efficiency is essential for economic resilience as it will contribute to an efficient allocation of resources enabling the economy to better withstand the effects of adverse shocks. There are three components to microeconomic market efficiency relating to: capital mobility, labour market flexibility and product market efficiency.

85. In terms of capital mobility, the Seychelles have a recent history of restraints on domestic financial activity, exchange rate overvaluation and the imposition of exchange controls. These restrictions are recently being gradually lifted, and significantly, the Central Bank is now operating independently of Government as part of the Macroeconomic Reform Programme initially launched in 2003. Contributing to the enhancement in the efficiency of capital resources allocation were the initiation of a proactive monetary policy since mid-2006, the enactment of a legislative framework to enable the development of a modern financial system since 2004¹⁰, and the initiation of a gradual process of exchange control liberalisation in October 2006. These developments are steps in the right direction but call for further progress in this area.

86. With regards to labour market efficiency, policy structures or directions in this sense are being put in place only very recently, in spite of the chronic shortages in labour supply which resulted in significant inflows of expatriate workers. An employment agency will be set up as a result of the 2008 Budget. The Strategy 2017 is possibly the first concrete approach to an explicit labour market policy in the Seychelles, which encompasses a National Human Resources Development Policy which places significant emphasis on multi-skilling. There is however no information available regarding the availability of skills in the labour force which could enable the undertaking of a skills-gap analysis. Higher education opportunities are very constrained in the Seychelles, with the setting up of a University as yet being contemplated.

¹⁰ including the Central Bank Act, 2004; Financial Institutions Act, 2004; Anti-Money Laundering Act, 2006; and the Investment Code, 2005.

87. In terms of product market efficiency, it is noted that post-independence¹¹ economic policy relied substantially on command systems with strong involvement of government in productive activities. In early 1990s however, the Government initiated a process of gradual reform based mainly on the privatisation of state-owned firms, the relaxation of quantitative and tax controls on imports and on product prices, and the abolition of monopolies, with appropriate competition legislation being introduced. In particular the establishment of the Seychelles Marketing Board in 1984 to control the export and import of goods and eventually, their prices, was a significant disincentive to private sector development. The Board was privatised in 2007. However, controls on mark-ups on a wide variety of products remain, which are resulting in generally higher prices, shortages in some instances and possible wide variations of the same products in different shops with different cost structures. This is a significant drag on the efficient allocation of resources, as it incentivizes the maintenance of high cost structures.

88. The involvement by the Seychelles in regional trading arrangements is limited and is contemplated in the Strategy 2017 document. Property rights, including those of an intellectual nature, are generally well-protected in the Seychelles.

89. On the other hand, the Strategy 2017 document details a number of objectives to enhance efficiency in specific areas of activity. In the tourism sector, the actions contemplated include a revision of the marketing strategy by the Seychelles Tourism Board, rationalisation of existing tourism investment legislation, product enhancement, industry service improvement ensuring value for money, product base diversification, improvement in access to Seychelles and between the country's islands and the enhanced management of the tourism sector by restructuring the existing hotel school as a centre of tourism excellence. In the fisheries sector, there is the objective of increasing domestic processing, promoting exports and increasing Seychellois stakeholding in the industry with a long-term objective to turn Seychelles from being a fisheries transshipment hub to the primary seafood processing centre in the Indian Ocean. The Strategy 2017 document also aims at developing financial services into the third pillar of economic activity through the active promotion of available financial services, such as registration of international business companies, mutual and hedge funds, trading in securities and insurance activities.

Political Governance

90. With respect to political governance, the Seychelles has a system based on democratic principles. However, the country has been subject to pervasive state interference up to recent years but is now moving towards a stronger private sector involvement in economic affairs. Attempts at social dialogue are sporadic. Within this context, there is growing recognition for the need to further develop notions of government accountability and transparency with the active participation and development of existing institutions, primarily that of the Auditor General. The rule of law, the quality of the judiciary and the impartiality of the Law Courts are sufficient to contribute to effective governance in the Seychelles.

Social Development

91. With regards to social development, there are universal welfare programmes for education, health and housing in the Seychelles. However, official statistics indicate that

¹¹ The Seychelles gained independence in 1976.

around 9 per cent of the population suffered from undernourishment right up to 2004 and 20 per cent live under the poverty line. The distribution of income is tending to become more equitable over time, with social development being listed as a main objective of the 2017 document. As observed in the background section of this study, social development in terms of life expectancy and literacy tend to lack behind the state of economic development in the Seychelles. In 2005, a pension fund replaced the pension system, and covers workforce population who has worked continuously for 10 years or more. It thus does not cover casual workers, who are working part-time, and these may have inadequate savings for retirement.

Environmental Management

92. While man-made environmental problems do not appear to impinge to any significant extent in the Seychelles, environmental management structures appear to be lacking such that there is the risk that economic development could compromise the sustainability of the environment. Disaster and civil protection management systems also need to be improved in the face of the possible incidence of natural disasters and climate change.

Policy Implications and Conclusions

93. The principal economic resilience strengths that can be identified from this analysis include:

- efforts at promoting macroeconomic stability, as reinforced by the Strategy 2017 document, which however have so far not been sufficient to ensure long-term macroeconomic equilibrium;
- the liberalisation and modernisation of financial activities and the incipient development of the financial services sector;
- plans to enhance efficiency and the international competitiveness of the main pillars of the economy, namely tourism, fisheries and financial services;
- the maintenance of stable governance structures based on democratic principles and the rule of law; and
- the operation of universal welfare programmes aimed at promoting social cohesion.

94. The principal economic resilience weaknesses that can be discerned include:

From the macroeconomic perspective,

- an insufficient level of savings to sustain the significant level of investment needed at the current stage of the country's economic development.

From a microeconomic perspective

- the relatively slow pace of exchange control liberalisation with the persistence of an informal market for foreign currency, possibly hampering confidence in the economy, with savers looking overseas for investment;
- the absence of labour market policy structures and lacunae in higher education;
- the maintenance of margin controls on product prices, leading to over-invoicing and artificially high prices ; and

- an excessive focus on the key sectors of fishing and tourism, leading to a very high dependence on these sectors, and possibly precluding the development of other potentially innovative areas of economic success for the Seychelles, such as those related to ICT.

From a social perspective

- an insufficient involvement in social dialogue and NGO involvement in policymaking; and
- the persistence of poverty as evidenced by the percentage of persons who are undernourished;

From an environmental perspective

- inadequate governance structures for environmental management.

95. The policy implications that emerge from this analysis are based on further reinforcing the areas of strength while tackling the weaknesses. In general, the Strategy 2017 document is conducive towards these aims. Its main lacuna is probably its excessive concentration on the three main pillars of activity which have already been substantially exploited by Small Island Developing States and which leave little room for innovation in the global marketplace. Long-term competitive advantages can only be built through activities which allow for substantial innovation, and these nowadays can be found in the fields of ICT and scientific research. In the case of the Seychelles these can be associated with climate change and environmental management. It is probable that the Seychelles can enjoy a comparative advantage in these activities.

96. It is to be further stated that the issues being faced by the Seychelles at this stage may be summarized as:

- the need to promote macroeconomic balance;
- the need to accelerate the shift the economy away from a command style to a free-market driven system; and
- the need to develop the sectors in which the economy can enjoy and international competitive advantage.

SECTION III – PROFILE OF VULNERABILITY AND RESILIENCE IN ST. LUCIA

97. Saint Lucia is a small island state located in the Caribbean Sea. It has a population of approximately 171,000 persons. The country has a stable democracy and is member of the Organisation of Eastern Caribbean States (OECS), CARICOM and various international organizations.¹² In terms of population and economic size, Saint Lucia is the largest among the nine Small Island Developing States (SIDS) within the OECS, which account for a total population of 606,000 persons.¹³ Membership within the OECS entails regional cooperation in trade and development issues. Saint Lucia also participates within the Eastern Caribbean Central Bank, the currency of which, the Eastern Caribbean dollar, is fixed to the US dollar.¹⁴

98. The challenges to economic development faced by Saint Lucia are similar to those faced by other SIDS including a high degree of economic openness, relatively high dependence on a narrow range of exports, resource limitations, peripherality from major markets, high costs associated with international transport; and limited ability to exploit economies of scale. These realities lead to economic vulnerability mostly due to exposure to external economic shocks. In addition, the economic growth of Saint Lucia over the past ten years has been affected by natural disasters as well as loss of preferential treatment in its exports of bananas

99. Table 5 details a number of key economic and social indicators for Saint Lucia. The country had a per capita GDP of US\$5,721 in 2007, which the World Bank classifies as within the upper middle category.

100. Economic growth was sluggish during 2007, at 0.5 per cent in real terms. This reflected a marked downturn from the relatively high rates of growth sustained since 2001, which had peaked at 4.9 per cent in 2006. The slowdown in 2007 reflected a weak performance in the tourism sector, in good part due to the effects of global demand and high oil prices on holiday travel. It was also a result of lower construction activity following an investment boom in recent years (Saint Lucia, 2008). Adverse meteorological conditions and the continuing effects of declining preferential treatment and its ensuing uncertainty on production also affected banana exports in 2007. The IMF expects growth to recover somewhat in 2008 and 2009, mainly on account of increased tourism capacity generated by foreign direct investment inflows. However, the challenges to growth experienced in 2007, including the gradual erosion of preferences with respect to banana exports, are expected to persist.

101. The unemployment rate remained high at 14 per cent. The unemployment rate in Saint Lucia is strongly conditioned by demographic factors featuring a strong growth in the labour force entry age category, which has to some extent attenuated in 2007. Inflation for the entire year was contained at 2.7 per cent, although significant incipient inflationary pressures were in the offing on account of the weakening of the US dollar and the increase in commodity prices. This was reflected in an inflation rate at the year-end which reached 6.8 per cent and is likely to persist in 2008.

¹² including the Commonwealth, United Nations, IMF and World Bank.

¹³ <http://www.oecs.org/membs.html> accessed on 26 July 2008.

¹⁴ <http://www.oecs.org/units.html> accessed on 26 July 2008. One US dollar is equivalent to 2.7 Eastern Caribbean dollars.

102. Saint Lucia has a record of high and persistent fiscal deficits, which stood at almost 7 per cent of GDP in 2007. The authorities have embarked on a programme of fiscal consolidation, but the IMF (2008) comments that achieving sound public finances, particularly in relation to the current deficit, and ensuring debt sustainability remains a key challenge. The country also experienced persistent deficits on the external current account in recent years, which reached 30.3 per cent of GDP in 2007. This was partly a marked rise in imports related to foreign direct investment in the tourism industry, but in part also reflected difficulties, in spite of the depreciating US dollar, in export markets as well as the increase in prices of imported strategic commodities leading to adverse terms of trade. The IMF (2008) expects current account deficits to be reversed in the medium term and comments that they were in good part financed by non-debt-creating external capital inflows.

103. The country experienced significant shifts in economic activity during the past decade. Agriculture shrank from over 8 per cent to around 3 per cent of GDP, mainly on account of preference erosion in banana export markets. At the same time, the share of financial sector activity increased by over 6 percentage points to 13 per cent of GDP, with the IMF (2008) commenting upon the positive developments in the regulation and supervision of banks and international financial services providers. This sector was actually the main engine of economic growth in 2007. Manufacturing, construction and tourism maintained roughly constant shares of GDP over time, with the latter two sectors however showing a significant degree of volatility. In the case of construction, this is due to the cycle of the completion of projects. With respect to tourism, volatility reflects tendencies in international demand. Within manufacturing, one half of the output consists of food and beverages. The real estate sector increased its share within GDP by 2 percentage points during the past decade in a stable manner, and now accounts for around one-ninth of economic activity.

Table 5: Saint Lucia - Key Indicators

Variable	Level	Period
GDP - total (US\$M)	978	2007
- per capita (US\$)	5,721	2007
- real growth	0.5%	2007
Unemployment rate	14.0%	2007
Inflation rate	2.7%	2007
Fiscal balance (as a proportion of GDP)	-6.9%	2007
External current account balance (as a proportion of GDP)	-30.3%	2007
GDP composition:		
Agriculture	2.9%	2007
Manufacturing	5.6%	2007
Construction	7.0%	2007
Wholesale and retail	11.3%	2007
Hotels and restaurants	10.4%	2007
Transport	9.5%	2007
Communications	9.4%	2007
Banking and insurance	13.0 %	2007
Real estate	10.9%	2007
Life expectancy (years)	74.0	2006
Infant mortality (per thousand)	23.5	2007
Literacy rate	94.8%	2004

Sources: Saint Lucia (2008), World Bank

104. From the perspective of social development, Saint Lucia has a life expectancy at birth of 74 years, a relatively high infant mortality rate of 23.5 per thousand, and a literacy rate of almost 95 per cent. In this respect, it is to be commented that death rates, particularly those of infants, have increased significantly since 2003. Saint Lucia (2008) attributes this to lifestyle diseases.

An Assessment of the Symptoms of Economic Vulnerability

105. This facet relates to the manifestation of vulnerability or lack of resilience and attempts to determine whether a country appears to be suffering from any one or more of the symptoms of vulnerability or otherwise. This may be discerned by considering the levels and volatility over time of a number of key variables including: GDP; consumption; imports; exports; exchange rates and prices. The extent of reliance on short-term shock absorbers which may attenuate the effects of shocks and of insufficient resilience to them is also to be considered. These shock-absorbers include the extent of deficits on the external current account and the size of government expenditure. An analysis of these variables for the economy of Saint Lucia is presented in Charts 1 through to 6.⁶

106. During the decade to 2007¹⁵, Saint Lucia experienced an increase in per capita real GDP averaging 1.5 per cent per annum, which may be perceived to be relatively low for a country at its current state of development.¹⁶ This was underpinned by notable fluctuations in the level of real per capita GDP during the decade, which actually fell in 2001 and 2007, and recovered significantly especially between 2003 and 2005 (see Chart 1). This indicates a significant exposure to the effects of vulnerability and lack of resilience during the period under consideration, which includes a slow and relatively volatile pattern of growth. The development of GDP at current prices followed a similar trend, averaging at relatively low 2.6 per cent per annum. It may be noted that in recent years, growth in GDP at current market prices has been increasingly subject to inflationary pressures.

107. An analysis of private per capita consumption expenditure, presented in Chart 2, shows more accentuated trends of this nature. At constant prices, the variable advanced at an average rate of 3 per cent per annum between 1998 and 2007, but with notable fluctuations around the trend. At current prices consumption grew at a rapid pace during the decade under consideration, averaging 5.6 per cent per annum. It is noted that the average growth in consumption, as well as its volatility, significantly outstripped that registered in GDP.

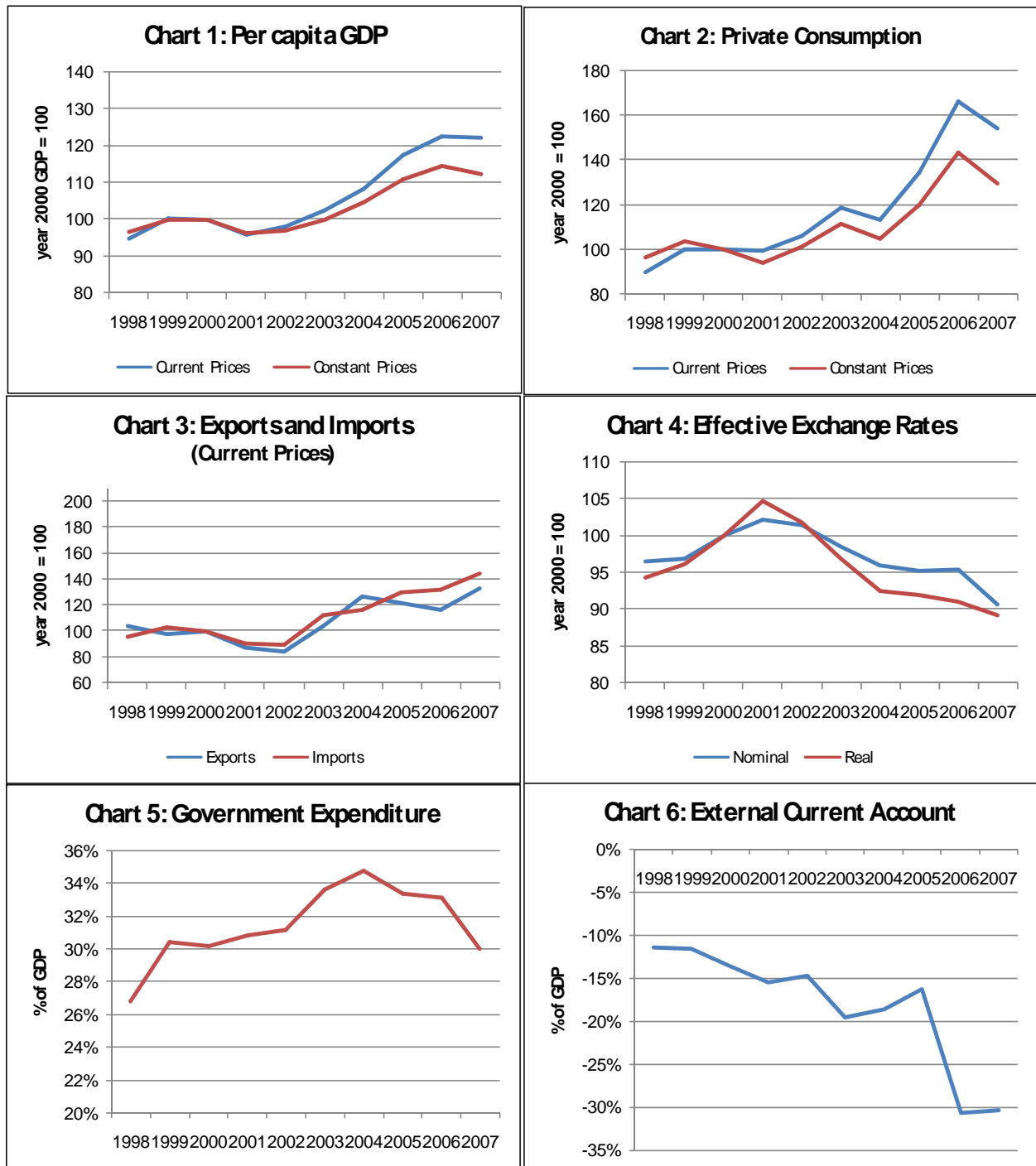
108. The volatility in output during the decade under consideration in good part mirrored fluctuations in exports, which during the period were conditioned by shocks to international demand, commodity prices, trade preference erosion and natural disasters. As a result of these factors, exports actually dropped in 2001/2 and in 2005/6. In the last three years of the analysis, GDP growth was also strongly affected by developments in construction, in turn resulting from foreign direct investment in the tourism sector (see Chart 3).¹⁷ The same

¹⁵ A complete and final dataset for the purposes of this analysis is available up to 2007. Reference to provisional data and estimates for 2008 is made where relevant.

¹⁶ The average growth over the decade for Saint Lucia is estimated at around 0.5 percentage points lower than that in the Latin American and East Caribbean group, and around 3 percentage points lower than the middle income country group (source: World Bank).

¹⁷ Data for imports and exports for Saint Lucia is only available at current market prices. This reflects the absence of expenditure side GDP at constant prices.

factors conditioned the development of imports during the period, which in the final two years were especially influenced by the increases in international commodity prices.



Source: Saint Lucia (2008), World Bank

109. Within the context of the currency anchor provided within the East Caribbean Central Bank arrangement, it does not appear that exchange rate shocks are being a significant source of vulnerability for Saint Lucia. This is indicated in Chart 4, which shows a persistent but gradual effective exchange rate depreciation in line with developments in the US dollar over past years, which has tended to contribute to external competitiveness without inducing currency volatility. On the other hand, inflationary pressures are starting to dent competitiveness advantages associated with a depreciating real exchange rate.

110. Turning next to the shock absorbers in the face of the effects of economic vulnerability, it is noted that Saint Lucia has relatively high government expenditure to GDP ratio which increased progressively right up to 2004, as shown in Chart 5. Efforts at fiscal consolidation since then led to a reduction in this ratio, implying that this tool cannot be resorted to indefinitely to absorb economic shocks.

111. Saint Lucia experienced a consistently negative and volatile performance on its external current account during the decade to 2007, as shown in Chart 6. This indicates a high degree of susceptibility to external economic conditions as discussed above, affecting export demand, the terms of trade as well as foreign direct investment into the country. Saint Lucia, therefore, went through developments usually manifesting economic vulnerability and lack of resilience during the decade to 2007. These were especially reflected in the low and sometimes negative rates of real economic growth, export volatility and a negative and volatile performance on the external current account. Data for 2007 and 2008 also indicate the emergence of significant inflationary pressures induced by shocks to import prices.

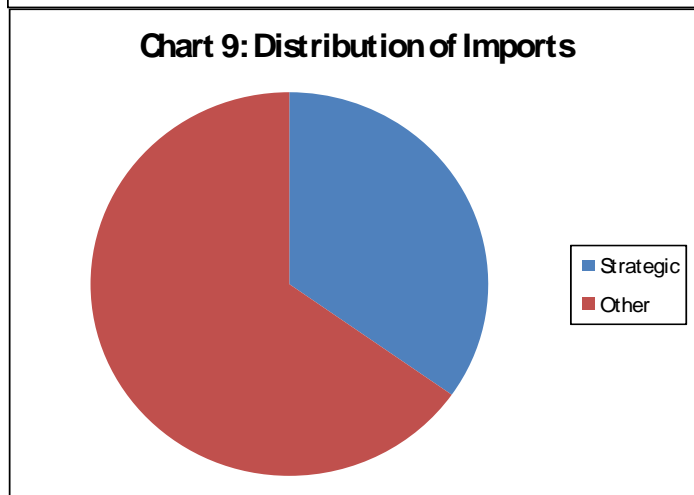
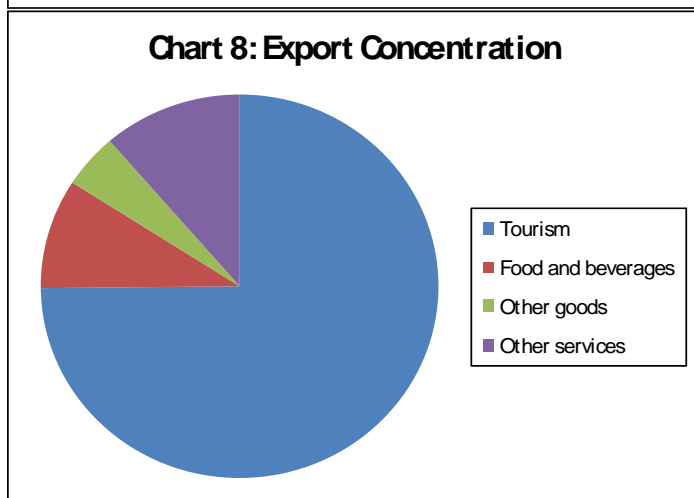
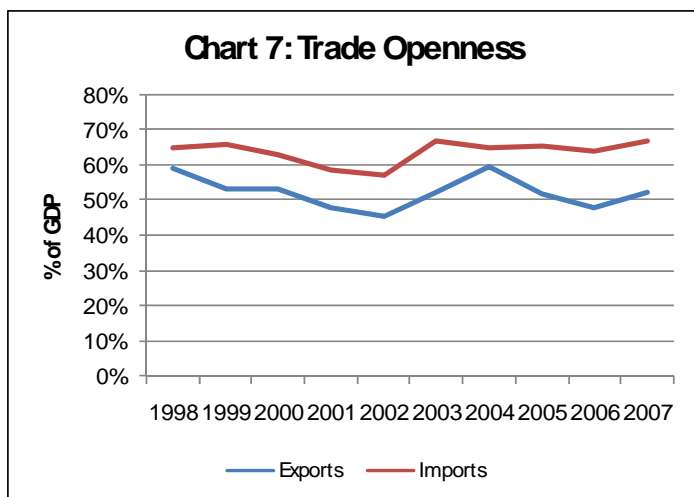
An Assessment of the Causes of Economic Vulnerability

112. The next step in developing the economic vulnerability and resilience profile is to determine the causes of the vulnerability giving rise to these manifestations of vulnerability. This facet of the profile relates to the underlying causes of vulnerability and is aimed at assessing the inherent fundamental conditions which may be rendering a country vulnerable to exogenous shocks. Charts 7 through 9 provide information on variables which proxy the exposure of Saint Lucia to exogenous shocks.

113. Chart 7 indicates that both imports and exports are substantial when compared to the country's GDP, typical of the levels of a country of the size of Saint Lucia. This is an indication of the fact that the economy is strongly influenced by developments in international markets. The risk of being affected by external shocks is even greater when the high degree of export concentration is taken into account. Around three-fourths of export receipts accrue from tourism, while another one-eighth is generated by food and beverages, as shown in Chart 8. Diversification into exports of other products and services remains limited, albeit it has been increasing in recent years. This implies that shocks to the two main export revenue sources are bound to have profound effects on the economy.

114. It is to be further considered that food exports are comprised mainly of bananas, which are a commodity export, with the consequent implications for volatility in prices and demand and trade preference erosion. Likewise, tourism has a volatile demand, conditioned by factors such as international economic growth, environmental risks, domestic and international political developments, changes in the availability of transport facilities and business decisions of international tour operators.

115. On the import side, close to 35 per cent of imports are made up of strategic commodities which are of the nature of necessities, including energy and food, as shown in Chart 9. This leaves the economy exposed to shocks in the international supply of these commodities, typically affecting their prices.

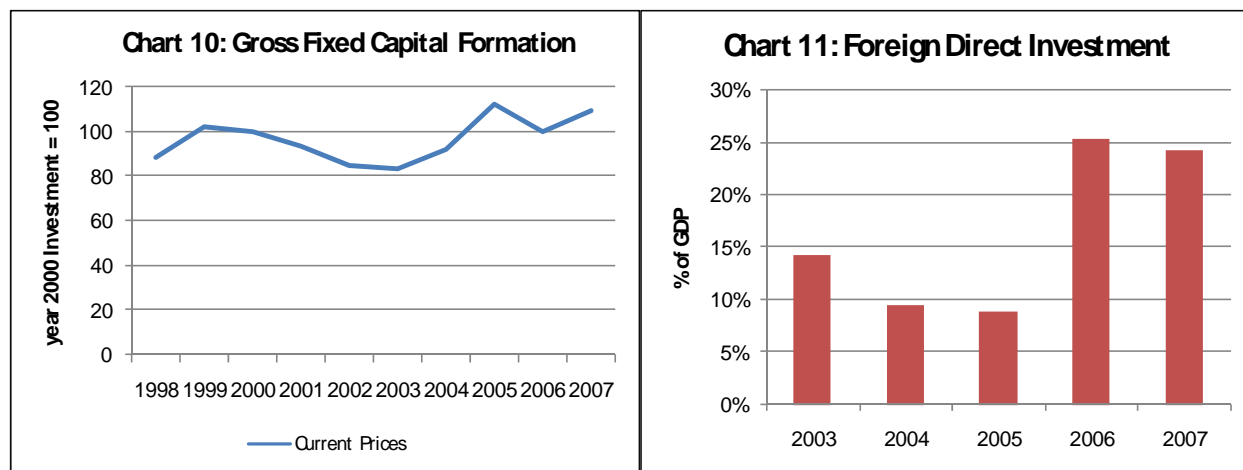


Source: Saint Lucia (2008)

116. The exposure to external shocks was an important determinant of the symptoms of vulnerability identified in the preceding section, including the relatively slow and volatile growth as well as the adverse and fluctuating performance on the external current account. This, however, must also be viewed in terms of the incidence or extent of occurrence of the shocks to which the country is exposed.

117. Chart 10 shows the part played by changes in gross fixed capital formation to economic development in Saint Lucia. Over the past decade, gross fixed capital formation

has fluctuated significantly. This in good part reflected changes to demand from the international sector, particularly with regard to the development of tourism infrastructure which in turn affected construction activity. The volatility in gross fixed capital formation in part reflects significant swings in foreign direct investment flows, which over the past five years has fluctuated from 7 per cent to 25 per cent of GDP, as shown in Chart 11.



Source: Saint Lucia (2008)

118. The incidence of shocks needs also to be evaluated, according to Briguglio et al (2008), by fluctuations to the GDPs of the main trading partner countries and to the terms of trade. In this regards, it may be commented that the main trading partners of Saint Lucia are other members of the OECS, which are themselves economically vulnerable countries as well as the United Kingdom, which is presently experiencing a significant slowdown in demand growth. Adverse terms of trade shocks are also known to have taken place, particularly with respect to the prices of banana exports and those of strategic commodity imports.

119. Thus, it can be concluded that the symptoms of vulnerability which Saint Lucia has experienced in the past decade are in part due to inherent structural features in the economy including its exposure to international business and commodity concentration, together with notable fluctuations in gross fixed capital formation. It cannot be excluded that frequent and significant shocks to external demand and to the terms of trade took place. Countries facing these types of shocks can however be successful in overcoming their effects through appropriate resilience-building policies, the assessment of which is the next element in this profile.

An Assessment of the Sources of Economic Resilience

120. This facet of the profile aims to highlight the strengths and weaknesses within the policy formulation milieu of a country towards the objective of economic resilience building. Economic resilience counteracts the effects of economic vulnerability by increasing the economy's ability to cope with the adverse effects of exogenous shocks. Briguglio et al. (2008) propose an approach which evaluates policy-induced economic resilience based on five dimensions namely: macroeconomic; market efficiency; governance; social development; and environmental management.

Macroeconomic Stability

121. Charts 12 through 15 present an analysis of the variables that are considered to proxy the extent to which macroeconomic policy is creating conditions that are conducive to the establishment of economic resilience. A fundamental requisite towards economic resilience is for a country to generate sufficient savings to create a buffer against potential shocks. The saving rate of the economy of Saint Lucia fluctuated around 15 per cent in 1999, but has since then slumped and became negative in 2007 at around -14 per cent of GDP, as shown in Chart 12. This is a direct result of consumption growth which exceeded that in GDP during the past decade, as observed earlier on. It also reflects the persistence of fiscal deficits, particularly on the current fiscal balance. An insufficient level of saving is not sustainable in the medium term and could adversely impact on the economic resilience of the economy of Saint Lucia.

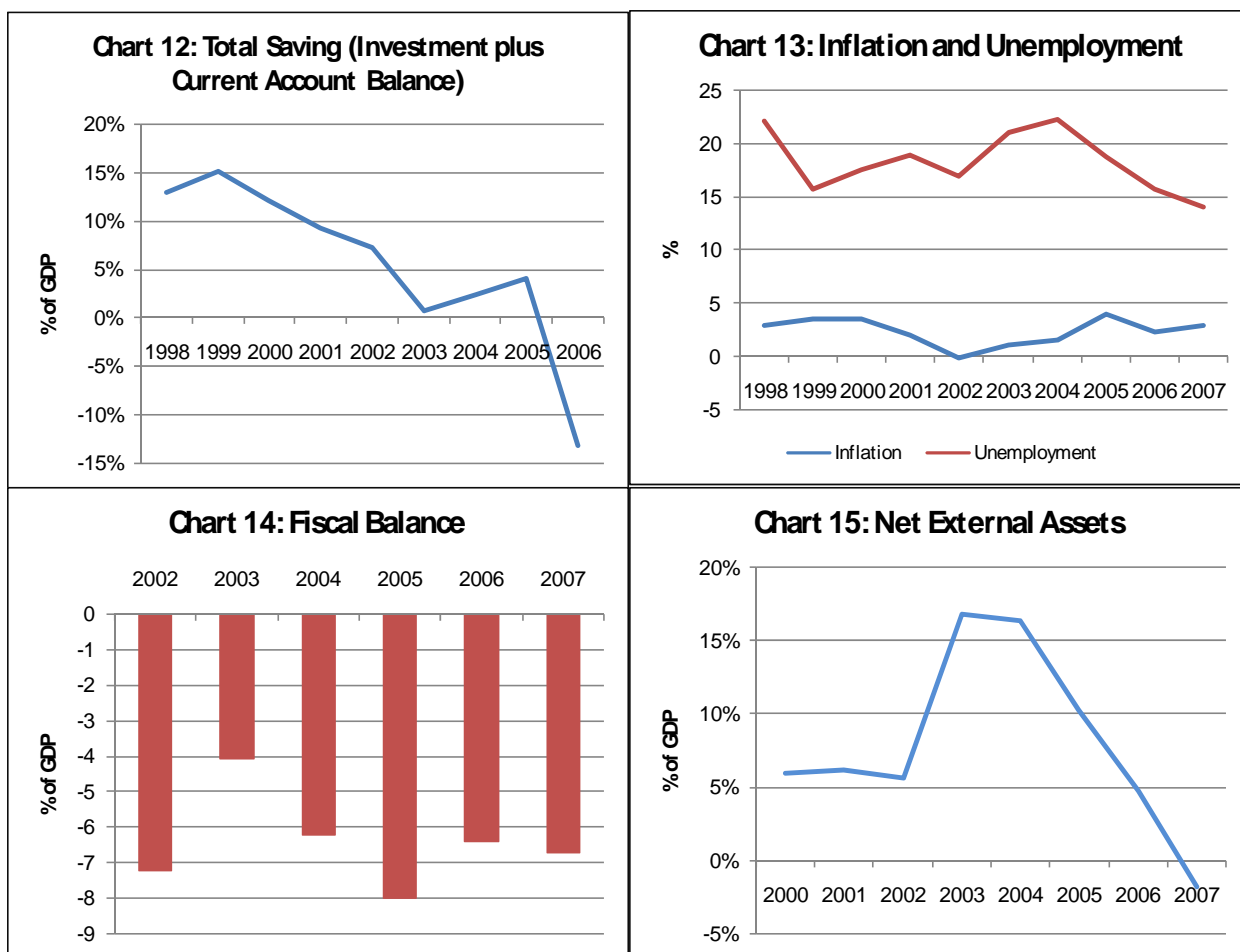
122. Developments in inflation and unemployment are shown in Chart 13. To promote economic resilience, it is important for these variables to be at low levels so that if adverse shocks should hit the economy, they would not further aggravate a serious situation. On account of the currency anchor combined with low inflation in trading partner countries, inflation was relatively low during the past decade, but has responded to the increase in prices of commodity imports in the past two years.

123. The unemployment rate is persistently high in Saint Lucia, a reflection of a significant inflow of population into the working age category which is not being matched by demand for jobs.¹⁸ The difference between supply and demand has tended to narrow since 2005, albeit this trend has slowed down in 2007 owing to the lacklustre economic growth. High unemployment, with its economic, social and political implications, may be considered as a serious drawback to the resilience of Saint Lucia.

124. The fiscal balance showed a persistent deficit which is lately being to some extent addressed, as shown in Chart 14. A lack of fiscal policy discipline, which has also impinged negatively on the levels of public and external debt, is another important constraint to the economic resilience of Saint Lucia.

125. The net external asset position gives another indication of the availability of buffer reserves from which to meet the effects of adverse shocks. Chart 15 shows that the net external asset position of Saint Lucia was healthy for a number of years, but it turned negative in 2007. This, once again, is a reflection of excessive expenditure relative to output as well as of the effects of economic vulnerability. This is another matter of potential concern regarding the resilience of Saint Lucia from a macroeconomic viewpoint.

¹⁸ The youth unemployment rate is estimated at around 34 per cent.



Source: Saint Lucia (2008)

Microeconomic Market Efficiency

126. Microeconomic market efficiency is essential for economic resilience as it will contribute to an efficient allocation of resources enabling the economy to better withstand the effects of adverse shocks. There are three components to microeconomic market efficiency relating to: capital mobility, labour market flexibility and product market efficiency.

127. In terms of capital mobility and financial market efficiency, conditioned as they are by participation in the Eastern Caribbean Central Bank, Saint Lucia does not appear to have any serious threats to resilience. Further developments in regulatory structures are warranted so as to continue to consolidate the sector.

128. With regards to labour market efficiency, policy structures or directions aimed at addressing the persistently high rates of unemployment do not appear to exist. Education structures, while delivering high primary and secondary enrolment rates and high literacy rates, appear to be somewhat detached from the needs associated with the country's economic development potential. Opportunities for higher education, lifelong learning, re-skilling and multi-skilling appear may be severely limited in Saint Lucia. St. Lucia is a contributing member of the University of the West Indies and is also the beneficiary of grant/scholarship assistance from several countries, but the country has not adapted well enough to the changing needs in education. There are also significant challenges in pre-tertiary education, reflected in drop-out rates by young people from the formal education system and a low quality of education in some areas.

129. In terms of product market efficiency, there are in general no grave concerns save for the pricing of fuels, which is an important production and consumption element in the country. Regulatory interventions within monopolistic markets are not producing the desired results in terms of pricing efficiency, such that an overhaul of the system is advocated. There otherwise appear to be sufficient structures for the proper operation of product markets, although this comment is to be qualified by the fact that small market size may be leading to insufficiencies in the overall competition environment.

130. The involvement by Saint Lucia in regional trading arrangements is fostered by its participation in the OECS and CARICOM, which is considered to be a positive resilience element for the country. Property rights, including those of an intellectual nature, are generally well-protected in Saint Lucia.

131. In terms of fostering productivity, competitiveness and growth, it appears that the bulk of investment and economic development is being directed to the tourism sector. While this sector presents considerable opportunities for Saint Lucia, such an approach may result in an unbalanced pattern of growth with an increasing production concentration, and hence proneness to vulnerability. A development strategy involving a broader base of production, including the development of higher-value added and innovative areas such as ICT and renewable energy technological development may be contemplated as well as the pursuit of better inter-industry linkages between tourism and agri-processing.

Political Governance

132. With respect to political governance, Saint Lucia has a system based on democratic principles. However, the country appears to need a deeper engagement in social dialogue, as the policy-making agenda is often dominated by two major political parties leaving little space for NGOs and other organisations. Within this context, there is growing recognition for the need to further develop notions of government accountability and transparency with the active participation and development of existing institutions. The rule of law, the quality of the judiciary and the impartiality of the Law Courts are sufficient to contribute to effective governance in Saint Lucia.

Social Development

133. With regards to social development, there are concerns surrounding the health system in Saint Lucia, due to the increases in death rates, particularly those of infants, in recent years. The economy's income levels as well as constraints on fiscal expenditure have resulted in an underdeveloped system of welfare and poverty prevention. This problem is further accentuated by the high levels of unemployment in the country, entailing that poverty and its prevention remain crucial challenges to be tackled in order to effectively build social cohesion. In view of the resource limitations, poverty alleviation programmes must be implemented efficiently and selectively so as to target the most urgent needs, making the best possible use of donor engagement. Social cohesion is also adversely affected by the emergence of vulnerable economic categories of society, particularly the people who are involved in banana production, as well as by linguistic and urban-rural dichotomies. Statistical tools to better assess the poverty and social cohesion concerns of Saint Lucia also need to be developed.

Environmental Management

134. Man-made environmental problems do not appear to impinge to any significant extent in Saint Lucia; however the incidence of natural disasters is a matter of concern. Disaster management and civil protection management systems have improved in recent years, but further progress is called for in this crucial area, especially in the development of appropriate insurance schemes and early warning systems. Environmental governance institutions are also relatively underdeveloped and can be expected to become a necessity in future with the further development of construction, real estate and tourism activity. Issues such as deforestation and coastal zone management may call for attention in the near future.

Policy Implications and Conclusions

135. The principal economic resilience strengths that can be identified from this analysis include:

- the potential of further developing the economy in key areas such as tourism and financial services, the latter having attracted considerable foreign direct investment in recent years;
- participation in the OECS and in the Eastern Caribbean Central Bank which provide a measure of resilience in the external trade and monetary dimensions;
- the maintenance of stable governance structures based on democratic principles and the rule of law; and
- a relatively successful system of basic education.

136. The principal economic resilience weaknesses that can be discerned include:

From the macroeconomic perspective

- an insufficient level of savings to sustain the significant level of investment needed at the current stage of the country's economic development;
- excessive fiscal deficits, in part due to the mounting demand on the public sector for economic and social services in the wake of shocks; and
- excessive domestic consumption relative to the production of income, which is leading to an unsustainable external asset position.

From a microeconomic perspective

- the absence of labour market policy structures and lacunae in higher and further education and skills acquisition;
- inefficiencies in the pricing of fuel; and
- an excessive focus on the key sectors of tourism, leading to a high dependence on this sector, and possibly precluding the development of other potentially innovative areas of economic success for Saint Lucia, such as those related to ICT or environmental technologies.

From a social perspective

- an insufficient involvement in social dialogue and NGO involvement in policymaking; and
- the persistence of poverty in the face of resource constraints and high rates of unemployment, with the relative problems likely to exacerbate in the wake of the increases in energy and food prices;

From an environmental perspective

- the need for further improvement in governance structures for environmental and disaster management, particularly in the development of insurance schemes and early warning systems.

137. The policy implications that emerge from this analysis may be synthesised as:

- the need to engender macroeconomic balance, first and foremost by addressing the fiscal deficit through efficient and inexpensive revenue generating mechanisms (such as VAT) and an effective prioritization of expenditures (especially for capital programmes);
- the need to address insufficient demand for labour by promoting a balanced and diversified growth strategy while enhancing opportunities for skills acquisition, particularly with regards to re-skilling and multi-skilling of the labour force, including the possibility of a managed influx of skilled labour within CARICOM arrangements;
- the need to develop the social model in an effective and efficient manner so as to be able to build social cohesion at the lowest possible cost; and
- the need to enhance environmental and disaster management governance structures.

138. An ancillary issue is the need to have better statistical reporting systems particularly in the area of social development in order to be better able to gauge the extent of the challenges and to devise appropriate policy interventions.

139. Other Small Island Developing States have successfully dealt with these basic development issues in recent years and nowadays enjoy a substantial degree of economic resilience. It is probably useful for the country of Saint Lucia to closely follow instances of best practice from other Small Island Developing States in order to devise solutions that are most suited to its current and future development needs. It is however recognized that in the case of Saint Lucia, the reliance on international donor involvement and assistance remains crucial for the development of economic resilience.

References

- Atkins, J., Mazzi, S. and Easter, C. (2000). *A Commonwealth Vulnerability Index for Developing Countries: The Position of Small States*. London: Commonwealth Secretariat
- Briguglio, L. (1992). *Preliminary Study on the Construction of an Index for Ranking Countries According to their Economic Vulnerability*, UNCTAD/LDC/Misc.4.
- Briguglio, L. (1995). "Small Island Developing States and their Economic Vulnerabilities," *World Development*, Vol. 23 (9): 1615-1632
- Briguglio, L. (1997). *Alternative Economic Vulnerability Indices for Developing Countries*. Report prepared for the Expert Group on the Vulnerability Index. New York: UNDESA, 17-19 December
- Briguglio, L. (2003). "The Vulnerability Index and Small Island Developing States: A Review of Conceptual and Methodological Issues." Paper prepared for the AIMS Regional Preparatory Meeting on the Ten Year Review of the Barbados Programme of Action: Praia, Cape Verde
- Briguglio, L. and Galea, W. (2003). "Updating the Economic Vulnerability Index." *Occasional Chapters on Islands and Small States*, No. 2003-4 Malta: Islands and Small States Institute, University of Malta
- Briguglio, L., Cordina, G., Farrugia, N., Vella, S. (2006). "Conceptualising and Measuring Economic Resilience", in L. Briguglio, G. Cordina and E.J. Kisanga (eds.), *Building the Economic Resilience of Small States*, Malta: Islands and Small States Institute of the University of Malta and London: Commonwealth Secretariat, p. 265-288.
- Chander, R. (1996). *Measurement of the Vulnerability of Small States*, Washington: World Bank.
- Cordina, G. (2004a). "Economic Vulnerability, Resilience and Capital Formation", in Briguglio, L. and Kisanga, E.J. (eds) *Economic Vulnerability and Resilience of Small States*. Malta: Islands and Small States Institute and London: Commonwealth Secretariat: 104-112
- Cordina, G. (2004b). "Economic Vulnerability and Economic Growth: Some Results from a Neo-Classical Growth Modelling Approach," *Journal of Economic Development*, Vol. 29 (2): 21-39
- Cordina, G. (2008). "The Macroeconomic and Growth Dynamics of Small States", *Small States Economic Review and Basic Statistics*, vol. 12, London: Commonwealth Secretariat.
- Cordina, G. and Farrugia, N. (2005). "A Review of Vulnerability Indices and A Proposal Towards an Improved Conceptual Approach", *Occasional Paper*, Institute for Islands and Small States Studies, University of Malta.
- Crowards, T. (2000). *An Economic Vulnerability Index for Developing Countries, with Special Reference to the Caribbean: Alternative Methodologies and Provisional Results*, Caribbean Development Bank.
- Guillaumont, P. (2004) "On the Economic Vulnerability of Low Income Countries" In Briguglio, L. and Kisanga, E.J. (eds) *Economic Vulnerability and Resilience of Small States*. Malta: Islands and Small States Institute and London: Commonwealth Secretariat: 54-71
- Gwartney, J. and Lawson, R. (2005). *Economic Freedom of the World 2005 Annual Report*. Vancouver: Fraser Institute

- Jayaraman, T. K. (2006). “Macroeconomic Reform and Resilience Building in Small States”, in L. Briguglio, G. Cordina and E.J. Kisanga (eds.), *Building the Economic Resilience of Small States*, Malta: Islands and Small States Institute of the University of Malta and London: Commonwealth Secretariat, p. 33-58.
- Kaufmann D., Kraay A., and Mastruzzi M. (2006). *Governance Matters V: Governance Indicators for 1996-2005*, World Bank.
- Pace, R. (2006). “Malta and EU Membership: Overcoming Vulnerabilities, Strengthening Resilience”, *Journal of European Integration*, vol. 28, no. 1, p. 33-49.
- Springer, C. (2006). “Economic Resilience and Social Cohesion: The Case of Small Island States in the Eastern Caribbean”, in Briguglio, L. and Kisanga, E.J. (eds) *Economic Vulnerability and Resilience of Small States*. Malta: Islands and Small States Institute and London: Commonwealth Secretariat: 196-211.
- UNCTAD (2003). *Handbook of Statistics*. Geneva: UNCTAD UNDP (2002, 2003, 2004) *Human Development Report*. New York: Oxford University Press
- United Nations Committee for Development Policy (2006). *Overcoming Economic Vulnerability and Creating Employment*. Report of the Committee for Development Policy on the Eighth Session (20–24 March 2006), United Nations, New York
- Wells, J., (1997). *Composite Vulnerability Index: A Revised Report*, London: Commonwealth Secretariat.

STATISTICAL SOURCES

World Bank, *World Development Indicators*, Online Database
 UNCTAD, *Handbook of Statistics*, United Nations, 2007

THE FINAL STATEMENT – ST LUCIA

**CONSULTATION CONFERENCE
PROFILING ECONOMIC VULNERABILITY AND RESILIENCE
Rodney Bay, St Lucia: 16-17 June 2008**

We, participants attending the Consultation Conference on Profiling Economic Vulnerability and Resilience held in St Lucia, between 16 and 17 June 2008:

Economic Vulnerability and Resilience

1. Recognise that the St Lucia Consultation Conference has started a process of country profiling to assess the inherent features which lead to economic vulnerability, and the policies which are conducive to resilience building;
2. Anticipate that such profiling will complement the vulnerability and resilience indices, already developed, with an in-depth quantitative and qualitative data to enable the authorities of St Lucia as well as the donor community to identify gaps in capacity and to propose measures that need to be undertaken in order to enable the country to strengthen its ability to withstand and recover from economic shocks;
3. Reaffirm that economic vulnerability limits the options of St Lucia and other small states in pursuing sustainable development goals;
4. Recognise that various inherent features of small states lead to economic vulnerability including:
 - their high dependence on international trade which, while bringing benefits to economic activity, also results in heavy exposure to events in global markets and to developments in the global trade regime, including preference erosion, over which they have little influence;
 - their high dependence on a narrow range of exports, dependence on strategic imports and their limited options for diversification;
 - their susceptibility to climate change and to disasters;
5. Recognise that the economic vulnerability of small states can lead to social and environmental vulnerability which should be addressed by relevant policy intervention;
6. Note that some small states have been able to achieve high levels of economic development in spite of their inherent vulnerabilities through appropriate policy orientations focused on building resilience while, at the same time, other vulnerable small states continue to face considerable development challenges;
7. Discussed different aspects of economic resilience building including priorities for action to underpin macroeconomic stability, microeconomic market efficiency,

political and environmental governance, and social development. An extensive debate took place on the need to build social capital;

8. Agree that resilience building in small states should be given priority in view of their high degree of economic vulnerability and reaffirm that the concept of economic resilience does not detract from their need for special consideration by the donor community by virtue of their inherent vulnerability;
9. Commend the work carried out by the Commonwealth Secretariat and the Islands and Small States Institute of the University of Malta in developing the vulnerability and resilience indices and of international and regional organisations that have supported efforts by small states to promote their sustainable development;

The role of the donor community in supporting economic resilience building

10. Recall the Mauritius Strategy adopted at the International Meeting to Review the Implementation of the Barbados Programme of Action for the Sustainable Development of Small Island Developing States, wherein, in Article 81 it was stated that “Consideration should be given to the establishment of a task force to elaborate a resilience index, supported by the international community” and called upon the international community to continue supporting SIDS in their attempt to build and strengthen their economic resilience in order to withstand the effects of adverse economic shocks;
11. Stress that while the individual countries themselves have an important responsibility for building their own economic resilience, there is a crucial role to be played by the international community in supporting small states in this endeavour;
12. Call upon the international donor community to develop a resilience funding facility in order to support the endeavors of small states in building capacity so as to strengthen their economic resilience with the aim of withstanding or bouncing back from the impacts of adverse exogenous shocks;
13. Propose that in addition to countries preparing their Article 4 Consultation within the IMF structure, the Poverty Reduction Strategy and Action Plan (PRSAP) and the Government’s annual budget, small states in particular should prepare a vulnerability and resilience profile in conjunction with the preparation of the Medium Term Development Strategy and in line with the template prepared in this consultation conference;
14. Agree that this Statement should be submitted to the Cabinet for the attention of Ministers and that the county profile paper identifying the resilience gaps and suggested policy interventions will also be submitted in due course;

Expression of Gratitude

15. Express our gratitude to the Government of St Lucia, the Commonwealth Secretariat, the Islands and Small States Institute of the University of Malta for taking the initiative to organise this successful conference.

THE FINAL STATEMENT - SEYCHELLES

**CONSULTATION CONFERENCE
PROFILING ECONOMIC VULNERABILITY AND RESILIENCE IN SMALL
STATES: THE CASE OF THE SEYCHELLES**

Date: 25-26 June 2008

Venue: Maison de Football, Mahé

We, participants attending the Consultation Conference on Profiling Economic Vulnerability and Resilience held in the Seychelles, between 25 and 26 June 2008:

Economic Vulnerability and Resilience

1. Recognise that the Seychelles Consultation Conference has started a process of country profiling to assess the inherent features which lead to economic vulnerability, and the policies which are conducive to resilience building;
2. Anticipate that such profiling will complement the vulnerability and resilience indices, with an in-depth quantitative and qualitative data to enable the authorities of the Seychelles as well as the donor community to identify gaps in capacity and to propose measures that need to be undertaken in order to enable the country to strengthen its ability to withstand and recover from economic shocks;
3. Reaffirm that economic vulnerability limits the options of the Seychelles and other small states in pursuing sustainable development goals;
4. Recognise that various inherent features of small states lead to economic vulnerability including:
 - their high dependence on international trade which, while bringing benefits to economic activity, also results in heavy exposure to events in global markets and to developments in the global trade regime, including preference erosion, over which they have little influence;
 - their high dependence on a narrow range of exports, dependence on strategic imports and their limited options for diversification;
 - their susceptibility to climate change and to natural disasters.
5. Recognise that the economic vulnerability of small states can exacerbate social and environmental vulnerabilities which should be addressed by relevant policy intervention;
6. Note that some small states have been able to achieve high levels of economic development in spite of their inherent vulnerabilities through appropriate policy orientations focused on building resilience while, at the same time, other vulnerable small states continue to face considerable development challenges;
7. Discussed different aspects of economic resilience building including priorities for action to underpin macroeconomic stability, microeconomic market efficiency, political and environmental governance, and social development;
8. Agree that resilience building in small states should be given priority in view of their high degree of economic vulnerability and reaffirm that the concept of economic

resilience does not detract from their need for special consideration by the donor community by virtue of their inherent vulnerability. This should be done in the context of dialogue and partnership with all stakeholders;

9. Commend the work carried out by the Commonwealth Secretariat and the Islands and Small States Institute of the University of Malta in developing the vulnerability and resilience indices and of international and regional organisations that have supported efforts by small states towards the promotion of their sustainable development;

The Role of the International Development Partners in Supporting Economic Resilience-Building

10. Recall the Mauritius Strategy adopted at the International Meeting to Review the Implementation of the Barbados Programme of Action for the Sustainable Development of Small Island Developing States, wherein, in Article 81 it was stated that “Consideration should be given to the establishment of a task force to elaborate a resilience index, supported by the international community” and call upon the international community to continue supporting small states in their attempt to build and strengthen their economic resilience in order to withstand the effects of adverse exogenous shocks;
11. Stress that while the individual countries themselves have an important responsibility for building their own economic resilience, there is a crucial role to be played by the international community in supporting small states in this endeavour;
12. Call upon the international development partners to develop a resilience funding facility in order to support the endeavours of small states in building capacity so as to strengthen their economic resilience with the aim of withstanding or bouncing back from the impacts of adverse exogenous shocks;
13. Propose that in addition to countries preparing their Article 4 Consultation within the IMF structure, the Poverty Reduction Strategy and Action Plan (PRSAP) and the Government’s annual budget, small states in particular should prepare a vulnerability and resilience profile in conjunction with the preparation of the Medium Term Development Strategy and in line with the template prepared in this consultation conference;

Follow-up by Government of Seychelles

14. Propose that the issue of resilience building be mainstreamed into the discussion related to the WTO Work Programme for Small Vulnerable Economies;
15. Agree that this Statement be submitted to the Cabinet for the attention of Government and that the country profile paper identifying the resilience gaps and suggested policy interventions will also be submitted in due course;

Expression of Gratitude

16. Express our gratitude to the Government of the Seychelles, the Commonwealth Secretariat and the Islands and Small States Institute of the University of Malta for taking the initiative to organise this successful conference.