

CONCEPTUALIZING AND MEASURING ECONOMIC RESILIENCE

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Summary. This paper develops a conceptual and methodological framework for the analysis and measurement of economic resilience. The working definition of economic resilience adopted in this paper is the “nurtured” ability of an economy to recover from or adjust to the effects of adverse shocks to which it may be inherently exposed. This concept is used to provide an explanation as to why a number of inherently vulnerable countries have attained relatively high levels of GDP per capita. The paper also presents a tentative approach aimed at developing an index of economic resilience covering four aspects namely macroeconomic stability, microeconomic market efficiency, governance and social development.

Keywords: Economic resilience, economic vulnerability, small states, macroeconomic stability, market efficiency, governance.

1. INTRODUCTION

Many small states¹ manage to generate a relatively high GDP per capita when compared to other developing countries² in spite of their high exposure to external economic shocks. This would seem to suggest, that there are factors which may offset the disadvantages associated with such vulnerability. This phenomenon was termed by Briguglio (2003) the "Singapore Paradox", referring to the reality that Singapore is highly exposed to external shocks, and yet this island state has managed to register high rates of economic growth and high GNP per capita. This reality can be explained in terms of the ability of Singapore to build its economic resilience.

Economic vulnerability is well-documented in the literature from the conceptual and empirical viewpoints (see for example Briguglio, 1995 and 2003; Crowards, 2000; and Atkins et al, 2000). Most studies on economic vulnerability provide empirical evidence that small states, particularly island ones, tend to be more economically vulnerable than other groups of countries, due mostly to a high degree of economic openness and a high degree of export concentration. These lead to exposure to exogenous shocks, which could constitute a disadvantage to economic development by magnifying the element of risk in growth processes. Cordina (2004a,b) shows that increased risk can adversely affect economic growth as the negative effects of downside shocks would be commensurately larger than those of positive shocks. The high degree of fluctuations in GDP and in export earnings registered by many small states is considered as one of the manifestations of such exposure (see Atkins et al, 2000).

This paper is structured as follows. The next section revisits the so-called "Singapore Paradox". Sections 3 and 4 deal with the definitions of economic vulnerability and economic resilience. Section 5 presents the preliminary results of an attempt to construct a resilience index. Section 6 describes the potential uses of the resilience index while section 7 concludes the study with a word of caution relating to the interpretation of results.

2. THE "SINGAPORE PARADOX"

As already explained, the "Singapore Paradox" refers to the seeming contradiction that a country can be highly vulnerable and yet attain high levels of GDP per capita. Briguglio (2003; 2004) explains this in terms of the juxtaposition of economic vulnerability and economic resilience and proposed a methodological approach in this regard. In this approach economic vulnerability was confined to inherent features which are permanent or quasi-permanent, while economic resilience was associated with man-made measures, which enable a country to withstand or bounce back from the negative effects of external shocks. Briguglio refers to this type of resilience as "nurtured". Cordina (2004a,b) presents a conceptual application of this approach by showing that saving and capital formation in an economy, in response to a situation of vulnerability, can be important sources of resilience.

On the basis of this distinction, Briguglio (2004) identifies four possible scenarios into which countries may be placed according to their vulnerability and resilience characteristics. These scenarios are termed as "best-case", "worst-case", "self-made", and "prodigal son".

Countries classified as "self-made" are those with a high degree of inherent economic vulnerability, but which adopt appropriate policies to enable them to cope with or withstand their inherent vulnerability. Countries classified as "self-made" are those that take steps to mitigate their inherent vulnerability by building their economic resilience, thereby reducing the risks associated with exposure to shocks.

Countries falling within the "prodigal son" scenario are those with a relatively low degree of inherent economic vulnerability, but which adopt policies that expose them to the adverse effects

of exogenous shocks. The analogy with the prodigal son is that these countries, though “born in a good family”, squander their riches.

The “best-case” scenario applies to countries that are not inherently highly vulnerable and which at the same time adopt resilience-building policies. On the other hand, the “worst-case” scenario refers to countries that are similarly inherently highly vulnerable and adopt policies that exacerbate the negative effects of their vulnerability.

These four scenarios are depicted in Figure 1, where the axes measure inherent economic vulnerability and nurtured resilience, respectively. In this scheme the best situation in economic terms falls in quadrant II. The vulnerable small island states that have adopted resilience-building policies would fall in quadrant I.

Figure 1 about here

This method of defining vulnerability in terms of inherent features and resilience in terms of policy-induced changes has a number of advantages. Firstly, the vulnerability index would refer to permanent (or quasi permanent) features over which a country can practically exercise no control and therefore cannot be attributed to bad governance. As such the index should not differ much over time. In other words, countries scoring highly on the index cannot be accused of inflicting vulnerability on themselves through misguided policy approaches.

Secondly, the resilience index would refer to what a country can do to mitigate or exacerbate its inherent vulnerability. Scores on this index would therefore reflect the appropriateness of policy measures.

Thirdly, the combination of the two indices would indicate the overall risk of being harmed by external shocks due to inherent vulnerability features counterbalanced to different extents by policy measures.

Given that vulnerability refers to permanent or semi-permanent characteristics which render countries more prone to exogenous shocks, it is not expected that a country moves vertically along the quadrants of Figure 1. But horizontal movement is possible for those countries that adopt measures which build resilience and vice-versa. It would thus be possible for countries to switch between the worst case and the self-made classifications, or the prodigal son and the best case classifications through changes in their economic policies.

By distinguishing between inherent economic vulnerability and nurtured economic resilience, it is possible to create a methodological framework for assessing the risk of being affected by external shocks, as shown in Figure 2.

Figure 2 about here

Figure 2 shows that risk has two elements, the first is associated with the inherent conditions of the country that is exposed and the second associated with conditions developed to absorb, cope with or bounce back from external shocks. The risk of being adversely affected by the shock is therefore the combination of the two elements. The negative sign in front of the resilience element indicates that the risk is reduced as resilience builds up.

3. ECONOMIC VULNERABILITY

Recent work on the economic vulnerability index (see Briguglio, 1995; 1997, Briguglio and Galea, 2003, Farrugia, 2004) is based on the premise that a country's proneness to exogenous shocks

stems from a number of inherent economic features, including high degrees of economic openness, export concentration and dependence on strategic imports.

Economic Openness. Economic openness can be measured as the ratio of international trade to GDP. A high degree of economic openness renders a country susceptible to external economic conditions over which it has no direct control. Economic openness is to a significant extent an inherent feature of an economy, conditioned mainly by a country's ability to efficiently produce the range of goods and services required to satisfy its aggregate demand. If a country's productive base is limited to a narrow range of products, it would have to rely on imports to service a substantial part of its expenditure needs and on exports to finance its import bill.

It may be argued that openness to international trade may be influenced by policy. Practical experience has however shown that trade policies tend to influence more the composition of a country's external trade flows, rather than their size. It can be further argued that openness to international trade could be a source of strength, in that it may indicate that a country is successfully participating in the international markets. This argument however 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.³

Export Concentration. Dependence on a narrow range of exports gives rise to risks associated with lack of diversification, and therefore exacerbates vulnerability associated with economic openness. Again 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 on merchandise trade (UNCTAD, 2003: section 8). Briguglio (1997) and Briguglio and Galea (2003) devised an alternative index which also takes services into account.

Dependence on strategic imports. Another facet of the exposure argument relates to the dependence on strategic imports, which would expose an economy to shocks with regard 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 GDP. Again, this condition is inherent in that it depends on country size, resource endowments and possibilities for import-substitution.

All vulnerability indices utilizing these variables come to the conclusion that there is a tendency for small states to be more economically vulnerable than other groups of countries.

4. ECONOMIC RESILIENCE

Economic resilience can be defined in many ways, but in this paper the term is used to refer to the ability to recover from or adjust to the negative impacts of external economic shocks.

4.1 Usefulness of Considering Resilience Building

The issue of resilience building is important for small states in view of the fact that such states tend to be inherently economically vulnerable, as already explained. In addition, the discussion on resilience sheds light as to why a number of vulnerable small states have managed to do well economically in spite of (and not because of) being highly exposed to external shocks. Consideration of resilience building also conveys the message that vulnerable states should not be complacent in the face of their economic vulnerability, but could, and should, adopt policy measures to enable them to improve their ability to cope with external shocks.

4.2 The Meaning of Economic Resilience

Most dictionaries define resilience in terms of the ability to recover quickly from the effect of an adverse incident. This definition originates from the Latin *resilire* 'to leap back'. In economic literature, the term has been used in at least three senses relating to the ability (a) to recover quickly from a shock; (b) to withstand the effect of a shock; and (c) to avoid the shock altogether.⁴

A. Ability of an economy to recover quickly. This is associated with the flexibility of an economy enabling it to bounce back after being adversely affected by a shock. This ability will be severely limited if, for example, there is a chronic tendency for large fiscal deficits or high rates of unemployment. On the other hand, this ability will be enhanced when the economy possesses discretionary policy tools which it can utilize to counteract the effects of negative shocks, such as a strong fiscal position, which would entail that policy-makers can utilize discretionary expenditure or tax cuts to contrast the effects of negative shocks. This type of resilience is therefore associated with "**shock-counteraction**".

B. Ability to withstand shocks. This suggests that the adverse effect of a shock could be absorbed or neutered, so that the end effect is zero or negligible. This type of resilience occurs when the economy has in place mechanisms to endogenously react to negative shocks to reduce their effects, which we can refer to as "**shock-absorption**". For example, the existence of a flexible, multi-skilled labor force could act as an instrument of shock absorption, as negative external demand shocks affecting a particular sector of economic activity can be relatively easily met by shifting resources to another sector enjoying stronger demand.

C. Ability of an economy to avoid shocks. In this paper, this type of resilience is considered to be inherent, and can be considered as the obverse of economic vulnerability.

5. THE CONSTRUCTION OF A RESILIENCE INDEX

5.1 Underlying difficulties

In this section, we present the results of an attempt to construct a composite index of economic resilience. Some words of caution are warranted at this stage. The choice of variables as components of the index is somewhat subjective. However care was taken to base the choice on a set of desirable criteria related to (a) appropriate coverage, (b) simplicity and ease of comprehension, (c) affordability, (d) suitability for international comparisons and (e) transparency. A more detailed consideration of these criteria is given in Briguglio (2003).

In addition, the summing of the components of the index also involves subjective choices, principally in selecting a weighting procedure. There is considerable debate in the literature on composite indices on this issue. Again, these questions are discussed in Briguglio (2003) and are not elaborated upon in this paper.

The compilation of the index encountered a number of problems with regard to data collection, the most important of which were associated with (a) lack or shortage of data and (b) non-homogenous definitions across countries. Briguglio (2003) considers these problems, referring to the fact that data problems occur particularly in the case of small states.

5.2 The Components of the Resilience Index

It is hypothesized that elements of **shock-absorbing** and **shock-counteracting** resilience in an economy can be found in the following areas:

- macroeconomic stability
- microeconomic market efficiency
- good governance

- social development.

All of these areas feature variables which are highly influenced by economic policy and which can serve for an economy to build its economic resilience to meet the consequences of adverse shocks.

Macroeconomic Stability

Macroeconomic stability relates to the interaction between an economy's aggregate demand and aggregate supply. If aggregate expenditure in an economy moves in equilibrium with aggregate supply, the economy would be characterized by internal balance, as manifested in a sustainable fiscal position, low price inflation and an unemployment rate close to the natural rate, as well as by external balance as can be indicated by the international current account position or by the level of external debt. These can be all considered to be variables which are highly influenced by economic policy and which could act as good indicators of an economy's resilience in facing adverse shocks.

The macroeconomic stability aspect of the resilience index is thus constructed 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 variables are available for a reasonably wide set of 102 countries spread over a spectrum of stages of development, size and geographical characteristics. The relative data and country ranking results are presented in Appendix 1.

Fiscal deficit. The government budget position is suitable for inclusion in the resilience index because it is the result of fiscal policy, which is one of the main tools available to government, and indicates resilience of a shock-counteracting nature. This is because a healthy fiscal position would allow adjustments to taxation and expenditure policies in the face of adverse shocks. The fiscal deficit, standardized as a ratio to GDP, is thus included in the resilience index proposed in this paper.

Inflation and unemployment. Price inflation and unemployment are also considered to be suitable indicators of resilience and at the same time they potentially provide additional information to that contained in the fiscal deficit variable. This is because price inflation and unemployment are strongly influenced by other types of economic policy, including monetary and supply-side policies. They are associated with resilience because if an economy already has high levels of unemployment and inflation, it is likely that adverse shocks would impose significant costs on it. If on the other hand, the economy has low levels of inflation and unemployment, then it can withstand adverse shocks to these variables without excessive welfare costs. In this sense, therefore, unemployment and inflation indicate resilience of a shock-absorbing nature. The sum of these two variables, also known as the Economic Discomfort Index (or Economic Misery Index), is thus included in the resilience index proposed here.

External Debt. The adequacy of external policy may be gauged through the inclusion of the external debt to GDP ratio. This is considered to be a good measure of resilience, because a country with a low level of external debt may find it more difficult to mobilize resources in order to offset the effects of external shocks. Thus, this variable would indicate resilience of a shock-counteracting nature.⁵

It may be surprising to observe that the United States is not among the first 10 placed in macroeconomic stability index, although it ranks at a relatively high place in the 12th position. On

the other hand a number of small states, notably Hong Kong and Singapore, rank high on the index. In this regard, it is to be borne in mind that this is not an indicator of economic development but one that represents the ability of the macroeconomy to absorb or counteract adverse economic shocks.

Microeconomic Market Efficiency

The science of economics views markets and their efficient operation through the price mechanism, as the best way to allocate resources in the economy. If markets adjust rapidly to achieve equilibrium, then the effects of shocks can be easily absorbed in the economy and the relative adjustments be readily affected. If, on the other hand, market disequilibria tend to persist, especially in the face of adverse shocks, then resources will not be efficiently allocated in the economy, resulting in welfare costs, manifested, for instance, in outflows of capital, unemployed resources and waste or shortages in the goods markets.

As an example, consider the case of financial markets. If, in the face of an adverse shock, markets respond efficiently by means of higher interest rates and lower asset prices, capital can be retained in the economy such that the adverse shocks are reflected in price variables rather than in the volume of physical investment which would have an important influence on economic activity. If, on the other hand, prices in the financial markets fail to properly adjust, then it would be more likely for capital to leave the economy in the face of an adverse shock, thereby affecting economic activity and employment. Similar considerations may be made for the way in which the labor and product markets equilibrate in the economy. These issues would have important implications for resilience of the shock-absorbing type.

There are not many available indicators of market efficiency which span a sufficiently wide range of countries as required for the purposes of this study. Following a search for suitable indicators,

it was decided to use data contained in the *Economic Freedom of the World Index* published by the Fraser Institute. This is a project which commenced in 1986 led by Professor Milton Friedman, Rose Friedman and Michael Walker, and is aimed at measuring the extent to which markets are operating freely, competitively and efficiently in 123 countries. This index uses quantitative/objective data as well as data from independent surveys and indirectly attempts to assess the effects of 38 government policies affecting economic freedom.

The index focuses on five major areas, with relative indicators, relating to the size of government, legal structure and security over property rights, access to sound money, freedom to trade internationally, and regulation of credit, labor and business. For the purposes of the microeconomic efficiency component the indicators selected are:

- i. the size of government, and;
- ii. freedom to trade internationally.

These are chosen on the basis of their relevance to the resilience concept with regard to market efficiency.

The size of government. The size of government is based on four indicators, namely (a) government consumption as a percentage of total consumption; (b) subsidies and transfers as a percentage of GDP; (c) the share of investment accounted for by public entities; and (d) top marginal income tax rate together with the income threshold at which it applies.

The share of government in the economy through consumption, investment and subsidies is considered to have a crowding-out effect on private sector involvement, thereby reducing the degree of autonomous resilience which freely-operating markets can produce.

Similar considerations apply in the case of taxation, where the top marginal tax rate is viewed as the extent of disincentives to work present in an economy, which could preclude work effort from allowing an economy to recover from adverse shocks.

Freedom to trade. The freedom to trade internationally considers the effects of revenues from tariffs, regulatory trade barriers, size of the trade sector, exchange rates and international capital market controls. In this paper, this is used as an indicator of the degree of interference by government in the international trade sector, which could preclude the economy from reacting flexibly to shocks by adjusting its patterns of international trade.

The relative data and country ranking results are presented in Appendix 1. The data used in the index covered 2000 through 2002. Small vulnerable countries can be found across the entire scale of placing in this index. This indicates that such countries are adopting different policy approaches in terms of microeconomic efficiency towards meeting adverse shocks.

Good governance

Good governance is essential for an economic system to function properly and hence, to be resilient. Governance relates to issues such as rule of law and property rights. Without mechanisms of this kind in place, it would be relatively easy for adverse shocks to result in economic and social chaos and unrest. Hence the effects of vulnerability would be magnified. On the other hand, good governance can strengthen an economy's resilience.

The *Economic Freedom of the World Index* has a component which is focused on legal structure and security of property rights. This is considered to be useful in the context of the present exercise in deriving an index of good governance. The Index covers the following indicators:

- i. judicial independence,

- ii. impartiality of courts,
- iii. the protection of intellectual property rights,
- iv. military interference in the rule of law; and
- v. political system and the integrity of the legal system.

The relative data and country ranking results are presented in Appendix 1. The data used in the index covered 2000 through 2002. The highest rankings on the governance index are the more economically advanced countries, with the first five placings occupied by major industrialized economies. Singapore, which was among the most resilient economies on economic criteria, ranks 14th in terms of governance. Vulnerable economies tend to obtain lower rankings on this count, but it still appears to be the case that the vulnerable economies enjoying a higher per capita GDP also tend to have better systems of governance.

Social Development

Social development is another essential component of economic resilience. This factor indicates the extent to which social relations in a society are properly developed, enabling an effective functioning of the economic apparatus without the hindrance of civil unrest. Social cohesion can also indicate 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. It is therefore hypothesized that social development is directly related to social cohesion, although this assertion cannot be tested empirically due to lack of data.

Social development in a country can be measured in a number of ways. Variables relating to income such as its dispersion and the proportion of the population living in poverty, the long term unemployment rate, indicating the proportion of the population with low skills and inadequate employment prospects, and the proportion of the population with low level of education could be

useful indicators. Still another possible approach would be to measure the number and extent of instances of industrial or civil unrest. These approaches are interesting but rather narrow in scope and very difficult to measure across countries.

The index presented in this paper utilizes the education and health indicators used to construct the Human Development Index (HDI) (UNDP, 2002; 2003; 2004).

Education. Education, as measured by the adult literacy rate and school enrolment ratios, is considered to be a good indicator of social development. Education is considered to be strongly positively correlated with social advancement and hence, is indicative of a social fabric which is conducive to economic resilience.

Health. Life expectancy at birth, which is the health indicator in the HDI, is considered to be suitable for measuring the health aspects in society. This in turn is likely to be related to medical facilities, housing and degree of proneness to accident or risk of injury. Again, high life-expectancy is considered to be conducive to economic resilience.

The relative data and country ranking results are presented in Appendix 1. The data used in the index relate to 2000 through 2002. The social advancement index is very strongly correlated with the degree of economic development, with the countries in the first 20 places on the index having an annual per capita GDP of at least US\$11,500. Small island states, including those with a high per capita GDP, rank from the 25th position downwards.

Correlation between the Components of the Index

The variables discussed above have been found to be positively related to each other, as shown in Table 1, but the correlation is somewhat weak, with the exception of good governance and

social development.

Table 1

Correlation Matrix

| | | | | |
|--------------------|------|------|------|---|
| Macroeconomic | 1 | | | |
| Market Efficiency | 0.18 | 1 | | |
| Good Governance | 0.29 | 0.02 | 1 | |
| Social Development | 0.21 | 0.11 | 0.66 | 1 |

The question arises therefore as to whether or not the social development index is redundant, given that its high correlation with good governance. Given that the correlation is not unduly high, it was decided to retain both components in the composite index.

Other Determinants of Economic Resilience

Economic resilience can also be viewed to be determined by a plethora of other factors apart from those mentioned above.

It may be argued, for example, that it could be useful to consider the effects of environmental management on economic resilience. The environment can be an important source of vulnerability by giving rise to shocks of an adverse nature, be they rapid events, such as earthquakes or in the form of a gradual degradation over time. In turn, these would have important repercussions on the economy and society. In this regard, the efforts being undertaken to compile the Environmental Sustainability Index (Esty et al, 2005) are commendable. Data on these factors are however not readily and extensively available across countries of different sizes,⁶ such that the utilization of this index within the present exercise would have significantly reduced the countries covered by the resilience index.

In addition, there is the possibility that incorporating an environmental management index could lead to the problem of redundancy i.e. using indicators which are highly correlated which would add no new information but would render the procedure unnecessary complex. In the case of the environmental management factors, the socio-economic resilience aspects covered by the variables discussed above are likely to be highly correlated with environmental management, although in the absence of data, this assertion cannot be tested.

5.3 The Resilience Index

The index was computed by taking a simple average of the four components just described, namely:

- (a) macroeconomic stability
- (b) microeconomic market efficiency
- (c) good governance
- (d) social development

All observations of the components were standardized using the well know transformation:

$$XS_{ij} = (X_{ij} - \text{Min}_j) / (\text{Max}_j - \text{Min}_j)$$

where: XS_{ij} is the value of the standardized observation i of variable j ;

X_{ij} is the actual value of the same observation;

Min_j and Max_j are the minimum and maximum values of variable j .

This transforms the values of observations in a particular variable array so that they take a range of values from 0 to 1.

The results of the averaging of the four components are shown in Appendix 1. The results show that the countries with the highest GDP per capita, are, as expected, those with the highest resilience scores, as shown in Figure 3.

Figure 3 about here

The Relation between GDP per Capita, Resilience and Vulnerability

An interesting finding is that GDP per capita of the different countries is to a very high extent explained by vulnerability and resilience. Using the OLS method of regression, GDP per capita (standardized as explained above) was regressed on the vulnerability index (as proposed in Briguglio and Galea, 2003: See Appendix 3) and on the resilience index produced in this study. The results are shown in Table 2.

Table 2
Regression Results

$$\mathbf{G = -.10 + .83 R - .13V}$$
$$T\ stats \quad -(1.8) \quad (9.9) \quad -(1.8)$$

$$R^2 = 0.56$$

$$N = 87$$

Where: G = GDP per capita; R = Resilience Index; and V = Vulnerability Index

All variables have been standardized as explained above, so that their values range between 0 and 1

This result confirms the hypothesis in Briguglio (2004) and Cordina (2004a and 2004b) that the performance of countries depends on their inherent vulnerability and their nurtured resilience. This is not an extraordinary finding, because it validates a very plausible assumption. However the results of the regression exercise has some interesting implications. In particular, the results

show that the economic well-being of nations is more dependent on man-made policies rather than on inherent vulnerabilities. The results also confirm that adequate policy approaches can be used to successfully overcome the handicaps posed by vulnerability.

5.4 The Scenarios

Going back to the scenarios proposed in Figure 1, it is possible to place the countries included in the index in the four quadrants shown in therein, using the resilience index proposed in this paper and the vulnerability index presented by Briguglio and Galea (2003). The results are shown in Figure 4.

Figure 4 about here

It should be pointed out here that the cut-off values (represented by the dashed lines in Figure 4) chosen for the quadrants are the averages of the vulnerability and resilience scores for all countries. This decision is subjective and the classification of countries will change if different cut-off points are chosen. Consequently it was decided to allow a "border-line" margin of +/-15% for the resilience index (shown by the semi-transparent rectangle) and countries falling within this margin are classified as 'borderline' cases.

Appendix 2 shows which countries have been classified within the different quadrants.

The overall tendencies that can be derived from Appendix 2 are that:

- (a) countries which fall in the "best-case" quadrant include the relatively large countries with a relatively high GDP per capita and with relatively low vulnerability scores.
- (b) countries which fall in the "self-made" quadrant include a number of small states with a high

vulnerability score.

(c) countries which fall in the “prodigal son” quadrant include relatively large countries and others with a low resilience score.

(d) countries which fall in the “worst case” quadrant include some small countries with relatively high vulnerability and low resilience scores.

6. THE USES OF THE RESILIENCE INDEX

Supporting decision-making, setting targets and establishing standards

Decision-making by the government and other authorities should lead to action which is systematic and coherent and based on transparent information. The Resilience Index may also be used to set the direction of action and to justify certain priorities. The index could also be useful for setting targets. For example, a country with low resilience scores in certain economic areas may set targets to step up its resilience with regard to that economic variable.

Monitoring and evaluating developments

Indices are of utmost importance to assess whether a given policy or decision is yielding the desired results and to assess whether changes of direction are needed. This is especially so if measured over time. In this way, decisions are not taken blindly or based only on hunches and feelings, but would be based on scientific information presented in index format.

Deriving quantitative estimates

An index summarizes complex phenomena, often yielding a single-value measure of the

phenomena under consideration. This is useful, if not essential, for donor countries and organizations when taking decisions regarding the allocation of financial and technical assistance, or for assigning special status to vulnerable countries.

Dissemination of information and drawing attention to the issue

The resilience index can be used to make the public more aware of certain problems, and to give high profiles to certain trends which can strengthen resilience. In this regard, indices can be used for communication and for alerting stakeholders about issues, including dangers, failures and success stories.

An index is a very good instrument for drawing attention to the issue being investigated. Thus for example, the exercise of computing an index of resilience may itself make decision-makers aware of the gravity of these problems. Such an exercise may also generate academic discussion and enhance awareness amongst scholars on the issues involved.

Focusing the discussion

Indices can help to develop a common language for discussion. One often finds that persons engaged in debate go off at tangents because of lack of common definitions. In the case of indices, the quantification of its components requires precise definitions, and this could help focus the discussion on matters directly relevant to the issue.

Promoting the idea of integrated action

Composite indices are generally constructed to measure multifaceted realities. This could help to foster an awareness of the interconnections between the components of the index. In the case of

economic resilience, for example, it is often not enough, and may even be counterproductive, to take action in one area in isolation from others. The resilience index proposed in this paper could therefore promote the need for an integrated action in this regard.

7. CONCLUDING CONSIDERATIONS

This paper dealt with conceptual and methodological aspects associated with economic resilience and its measurement. The index developed in this paper covers four areas of economic resilience namely macroeconomic stability, microeconomic market efficiency, governance and social cohesion. Each of these areas contain variables which are considered suitable to gauge the extent to which the policy framework is conducive to absorb and counteract the effects of economic shocks.

The results of this exercise can provide an explanation as to why inherently vulnerable countries may register high levels of GNP per capita. It is argued that countries may be economically successful because they are inherently not vulnerable, or because they are resilient in the face of the vulnerability they face. The obverse is also true, in that countries may be unsuccessful because they are not sufficiently resilient.

The paper has also shown that GDP per capita is positively related to economic resilience and negatively related to inherent economic vulnerability. Furthermore, per capita GDP is found to be more sensitive to resilience than to vulnerability.

The index produced in this study is very preliminary, and the work should be considered as still at an early stage of development. The results should therefore be interpreted with caution.

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ENDNOTES

1. In this study, the words state and country are used synonymously. There is no generally agreed definition as to which variable should be used to measure the size of countries and as to what should be the cut-off point between a small country and other countries. Generally speaking, population is used as an indicator of size. In this study, a country with a population of 1.5 million or less is considered to be a small one.
2. This finding is reported in many studies. See for example Briguglio (1995).
3. Farrugia (2004) elaborated further on these ideas by considering the economic strength of trading partners as a proxy for the probability of shocks to exports.
4. An analogy relating to an attack of influenza virus may help explain the three senses in which the term "resilience" has been used. A person exposed to the virus may (a) get infected but recovers quickly; (b) withstand the effect of the virus, possibly by being immunized; and (c) avoid the virus altogether by staying away from infection sources.
5. It is however to be stated that certain countries may have external debt not because of a weak policy framework but due to a highly-developed international financial activity. This is a recognised weakness in the use of this indicator. However the inclusion of other variables related to market efficiency and governance would to an extent "correct" this weakness, since these variables either exacerbate the effect of external debt in the presence of a weak policy framework or counteract it otherwise.
6. Esty et al (2005) do produce some results for a few small states but they were reluctant to include them in the Environmental Sustainability Index.

APPENDIX 1: DATA AND COUNTRY RANKING RESULTS

| Country | Macroeconomic stability | Microeconomic market efficiency | Social development | Good governance | Resilience Index | Country Ranking |
|--------------------|-------------------------|---------------------------------|--------------------|-----------------|------------------|-----------------|
| Albania | 0.281 | 0.198 | 0.782 | 0.331 | 0.398 | 73 |
| Argentina | 0.553 | 0.511 | 0.877 | 0.242 | 0.546 | 49 |
| Australia | 0.494 | 0.500 | 0.989 | 0.990 | 0.743 | 12 |
| Austria | 0.706 | 0.399 | 0.959 | 0.940 | 0.751 | 9 |
| Bangladesh | 0.650 | 0.457 | 0.278 | 0.117 | 0.376 | 78 |
| Barbados | 0.647 | 0.000 | 0.921 | 0.539 | 0.527 | 53 |
| Belgium | 0.676 | 0.422 | 0.984 | 0.791 | 0.718 | 14 |
| Belize | 0.220 | 0.253 | 0.771 | 0.545 | 0.447 | 68 |
| Bolivia | 0.490 | 0.573 | 0.646 | 0.095 | 0.451 | 67 |
| Brazil | 0.414 | 0.375 | 0.741 | 0.380 | 0.478 | 61 |
| Cameroon | 0.466 | 0.239 | 0.286 | 0.280 | 0.318 | 83 |
| Canada | 0.648 | 0.560 | 0.978 | 0.924 | 0.778 | 6 |
| Chile | 0.651 | 0.564 | 0.869 | 0.567 | 0.663 | 21 |
| China | 0.668 | 0.209 | 0.725 | 0.388 | 0.497 | 59 |
| Colombia | 0.442 | 0.232 | 0.771 | 0.147 | 0.398 | 74 |
| Costa Rica | 0.625 | 0.616 | 0.864 | 0.589 | 0.674 | 19 |
| Cote d'Ivoire | 0.446 | 0.402 | 0.071 | 0.198 | 0.279 | 87 |
| Croatia | 0.544 | 0.121 | 0.837 | 0.462 | 0.491 | 60 |
| Cyprus | 0.387 | 0.302 | 0.894 | 0.645 | 0.557 | 47 |
| Czech Republic | 0.589 | 0.418 | 0.866 | 0.603 | 0.619 | 29 |
| Denmark | 0.728 | 0.314 | 0.948 | 0.998 | 0.747 | 11 |
| Dominican Republic | 0.671 | 0.580 | 0.678 | 0.253 | 0.546 | 50 |
| Egypt, Arab Rep. | 0.605 | 0.370 | 0.540 | 0.392 | 0.477 | 63 |
| El Salvador | 0.670 | 0.719 | 0.670 | 0.288 | 0.587 | 38 |
| Estonia | 0.650 | 0.612 | 0.861 | 0.583 | 0.677 | 17 |
| Finland | 0.653 | 0.372 | 0.973 | 1.000 | 0.750 | 10 |
| France | 0.515 | 0.183 | 0.965 | 0.736 | 0.600 | 34 |
| Germany | 0.570 | 0.410 | 0.951 | 0.929 | 0.715 | 15 |
| Greece | 0.402 | 0.489 | 0.935 | 0.482 | 0.577 | 42 |
| Honduras | 0.449 | 0.556 | 0.613 | 0.092 | 0.428 | 72 |
| Hong Kong, China | 0.665 | 1.000 | 0.875 | 0.687 | 0.807 | 3 |
| Hungary | 0.459 | 0.455 | 0.842 | 0.636 | 0.598 | 35 |
| Iceland | 0.734 | 0.370 | 0.970 | 0.942 | 0.754 | 8 |
| India | 0.522 | 0.404 | 0.439 | 0.504 | 0.467 | 65 |
| Indonesia | 0.444 | 0.581 | 0.659 | 0.150 | 0.459 | 66 |
| Iran, Islamic Rep. | 0.612 | 0.285 | 0.657 | 0.504 | 0.514 | 57 |
| Ireland | 0.759 | 0.620 | 0.932 | 0.866 | 0.794 | 4 |
| Israel | 0.615 | 0.169 | 0.937 | 0.756 | 0.619 | 28 |
| Italy | 0.582 | 0.384 | 0.935 | 0.729 | 0.657 | 23 |
| Jamaica | 0.429 | 0.592 | 0.798 | 0.409 | 0.557 | 46 |
| Japan | 0.495 | 0.335 | 0.975 | 0.730 | 0.634 | 25 |
| Jordan | 0.414 | 0.334 | 0.747 | 0.623 | 0.529 | 52 |
| Kenya | 0.510 | 0.481 | 0.349 | 0.189 | 0.382 | 77 |

| | | | | | | |
|---------------------|-------|-------|-------|-------|-------|----|
| Kuwait | 0.597 | 0.444 | 0.766 | 0.653 | 0.615 | 30 |
| Latvia | 0.542 | 0.412 | 0.837 | 0.519 | 0.578 | 41 |
| Lithuania | 0.567 | 0.439 | 0.858 | 0.431 | 0.574 | 43 |
| Luxembourg | 0.204 | 0.469 | 0.902 | 0.883 | 0.615 | 31 |
| Madagascar | 0.389 | 0.377 | 0.308 | 0.237 | 0.328 | 81 |
| Malaysia | 0.743 | 0.450 | 0.766 | 0.533 | 0.623 | 26 |
| Malta | 0.506 | 0.344 | 0.880 | 0.679 | 0.602 | 33 |
| Mauritius | 0.618 | 0.531 | 0.722 | 0.619 | 0.623 | 27 |
| Mexico | 0.623 | 0.628 | 0.793 | 0.231 | 0.569 | 44 |
| Morocco | 0.517 | 0.235 | 0.447 | 0.539 | 0.434 | 71 |
| Nepal | 0.513 | 0.226 | 0.313 | 0.338 | 0.347 | 80 |
| Netherlands | 0.504 | 0.446 | 0.981 | 0.988 | 0.730 | 13 |
| New Zealand | 0.703 | 0.629 | 0.975 | 0.948 | 0.814 | 2 |
| Nicaragua | 0.064 | 0.488 | 0.597 | 0.151 | 0.325 | 82 |
| Nigeria | 0.494 | 0.342 | 0.286 | 0.146 | 0.317 | 84 |
| Norway | 0.575 | 0.282 | 0.984 | 0.876 | 0.679 | 16 |
| Pakistan | 0.420 | 0.303 | 0.262 | 0.165 | 0.287 | 86 |
| Panama | 0.600 | 0.607 | 0.820 | 0.348 | 0.594 | 36 |
| Papua New Guinea | 0.529 | 0.350 | 0.341 | 0.261 | 0.370 | 79 |
| Paraguay | 0.596 | 0.616 | 0.749 | 0.071 | 0.508 | 58 |
| Peru | 0.586 | 0.609 | 0.757 | 0.235 | 0.547 | 48 |
| Philippines | 0.474 | 0.574 | 0.787 | 0.244 | 0.520 | 55 |
| Poland | 0.587 | 0.334 | 0.883 | 0.525 | 0.582 | 39 |
| Portugal | 0.612 | 0.415 | 0.921 | 0.748 | 0.674 | 18 |
| Romania | 0.414 | 0.205 | 0.782 | 0.360 | 0.440 | 69 |
| Russian Federation | 0.537 | 0.340 | 0.768 | 0.263 | 0.477 | 62 |
| Senegal | 0.428 | 0.379 | 0.134 | 0.273 | 0.303 | 85 |
| Singapore | 1.000 | 0.844 | 0.886 | 0.884 | 0.903 | 1 |
| Slovak Republic | 0.469 | 0.342 | 0.842 | 0.497 | 0.538 | 51 |
| Slovenia | 0.674 | 0.115 | 0.910 | 0.618 | 0.579 | 40 |
| South Africa | 0.594 | 0.392 | 0.485 | 0.597 | 0.517 | 56 |
| Spain | 0.564 | 0.407 | 0.970 | 0.627 | 0.642 | 24 |
| Sri Lanka | 0.347 | 0.478 | 0.768 | 0.286 | 0.470 | 64 |
| Sweden | 0.496 | 0.243 | 1.000 | 0.926 | 0.666 | 20 |
| Switzerland | 0.575 | 0.649 | 0.954 | 0.923 | 0.775 | 7 |
| Thailand | 0.424 | 0.548 | 0.752 | 0.548 | 0.568 | 45 |
| Trinidad and Tobago | 0.656 | 0.434 | 0.796 | 0.530 | 0.604 | 32 |
| Tunisia | 0.531 | 0.264 | 0.676 | 0.624 | 0.524 | 54 |
| Turkey | 0.042 | 0.513 | 0.698 | 0.328 | 0.395 | 75 |
| Uganda | 0.536 | 0.481 | 0.256 | 0.303 | 0.394 | 76 |
| United Kingdom | 0.101 | 0.601 | 0.973 | 0.975 | 0.663 | 22 |
| United States | 0.661 | 0.650 | 0.948 | 0.903 | 0.791 | 5 |
| Uruguay | 0.543 | 0.456 | 0.883 | 0.483 | 0.591 | 37 |
| Venezuela, RB | 0.531 | 0.427 | 0.793 | 0.000 | 0.438 | 70 |

APPENDIX 2: THE FOUR SCENARIOS

| Country | Resilience Index | Vulnerability Index | Case | Borderline |
|---------------------|------------------|---------------------|-----------|------------|
| Singapore | 1.000 | 0.971 | Self made | |
| Estonia | 0.637 | 0.908 | Self made | |
| Kuwait | 0.538 | 0.731 | Self made | |
| Hong Kong | 0.845 | 0.713 | Self made | |
| Mauritius | 0.550 | 0.632 | Self made | |
| Luxembourg | 0.538 | 0.615 | Self made | |
| Iceland | 0.761 | 0.607 | Self made | |
| Malaysia | 0.551 | 0.587 | Self made | |
| Norway | 0.641 | 0.543 | Self made | |
| Trinidad and Tobago | 0.521 | 0.533 | Self made | |
| Israel | 0.545 | 0.443 | Self made | |
| Malta | 0.518 | 1.000 | Self made | Borderline |
| Panama | 0.504 | 0.837 | Self made | Borderline |
| Latvia | 0.478 | 0.718 | Self made | Borderline |
| Greece | 0.477 | 0.655 | Self made | Borderline |
| Lithuania | 0.472 | 0.466 | Self made | Borderline |
| Costa Rica | 0.632 | 0.436 | Best case | |
| Denmark | 0.749 | 0.407 | Best case | |
| Belgium | 0.704 | 0.384 | Best case | |
| Chile | 0.615 | 0.379 | Best case | |
| Ireland | 0.825 | 0.371 | Best case | |
| Netherlands | 0.722 | 0.364 | Best case | |
| New Zealand | 0.857 | 0.320 | Best case | |
| Czech Republic | 0.545 | 0.309 | Best case | |
| Finland | 0.754 | 0.286 | Best case | |
| Spain | 0.581 | 0.250 | Best case | |
| Portugal | 0.633 | 0.242 | Best case | |
| Austria | 0.756 | 0.216 | Best case | |
| Sweden | 0.620 | 0.208 | Best case | |
| Australia | 0.744 | 0.184 | Best case | |
| Switzerland | 0.795 | 0.178 | Best case | |
| Canada | 0.799 | 0.117 | Best case | |
| Japan | 0.568 | 0.106 | Best case | |
| United Kingdom | 0.614 | 0.106 | Best case | |
| Germany | 0.698 | 0.100 | Best case | |
| Italy | 0.606 | 0.082 | Best case | |
| United States | 0.819 | 0.060 | Best case | |
| Thailand | 0.463 | 0.363 | Best case | Borderline |
| El Salvador | 0.493 | 0.362 | Best case | Borderline |
| Slovenia | 0.481 | 0.307 | Best case | Borderline |
| Hungary | 0.511 | 0.294 | Best case | Borderline |
| Uruguay | 0.500 | 0.288 | Best case | Borderline |
| Poland | 0.486 | 0.175 | Best case | Borderline |
| France | 0.514 | 0.129 | Best case | Borderline |

| | | | | |
|--------------------|-------|-------|--------------|------------|
| Mexico | 0.464 | 0.046 | Best case | Borderline |
| Belize | 0.269 | 0.768 | Worst case | |
| Nigeria | 0.061 | 0.677 | Worst case | |
| Egypt, Arab Rep. | 0.317 | 0.658 | Worst case | |
| Uganda | 0.184 | 0.597 | Worst case | |
| Nicaragua | 0.074 | 0.578 | Worst case | |
| Honduras | 0.238 | 0.534 | Worst case | |
| Cote d'Ivoire | 0.000 | 0.524 | Worst case | |
| Kenya | 0.165 | 0.511 | Worst case | |
| Iran, Islamic Rep. | 0.377 | 0.508 | Worst case | |
| Papua New Guinea | 0.146 | 0.508 | Worst case | |
| Croatia | 0.340 | 0.480 | Worst case | |
| Venezuela, RB | 0.254 | 0.465 | Worst case | |
| Madagascar | 0.078 | 0.465 | Worst case | |
| Senegal | 0.039 | 0.464 | Worst case | |
| Jamaica | 0.446 | 0.922 | Worst case | Borderline |
| Cyprus | 0.445 | 0.840 | Worst case | Borderline |
| Dominican Republic | 0.427 | 0.768 | Worst case | Borderline |
| Jordan | 0.401 | 0.725 | Worst case | Borderline |
| Barbados | 0.397 | 0.717 | Worst case | Borderline |
| Philippines | 0.386 | 0.485 | Worst case | Borderline |
| Sri Lanka | 0.306 | 0.415 | Prodigal son | |
| Cameroon | 0.062 | 0.397 | Prodigal son | |
| Pakistan | 0.013 | 0.349 | Prodigal son | |
| Albania | 0.191 | 0.344 | Prodigal son | |
| Nepal | 0.109 | 0.327 | Prodigal son | |
| Bangladesh | 0.155 | 0.313 | Prodigal son | |
| Bolivia | 0.276 | 0.299 | Prodigal son | |
| Paraguay | 0.367 | 0.297 | Prodigal son | |
| Morocco | 0.249 | 0.272 | Prodigal son | |
| Colombia | 0.191 | 0.254 | Prodigal son | |
| Russian Federation | 0.318 | 0.241 | Prodigal son | |
| Romania | 0.258 | 0.206 | Prodigal son | |
| India | 0.301 | 0.201 | Prodigal son | |
| Turkey | 0.186 | 0.182 | Prodigal son | |
| Indonesia | 0.288 | 0.174 | Prodigal son | |
| Brazil | 0.318 | 0.001 | Prodigal son | |
| China | 0.350 | 0.000 | Prodigal son | |
| Tunisia | 0.392 | 0.426 | Prodigal son | Borderline |
| Slovak Republic | 0.414 | 0.357 | Prodigal son | Borderline |
| Peru | 0.429 | 0.242 | Prodigal son | Borderline |
| South Africa | 0.381 | 0.147 | Prodigal son | Borderline |
| Argentina | 0.428 | 0.100 | Prodigal son | Borderline |

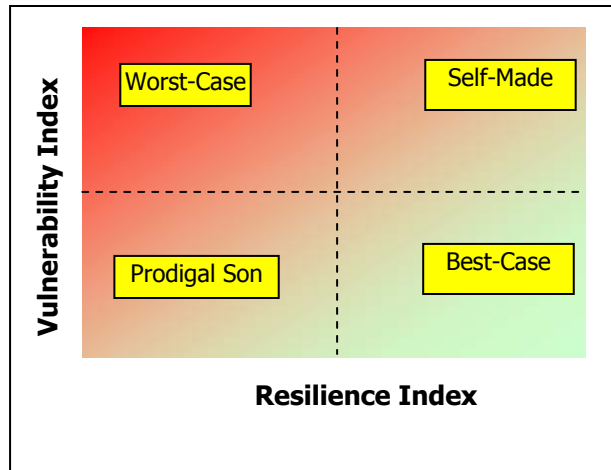
APPENDIX 3: THE BRIGUGLIO AND GALEA VULNERABILITY INDEX

| Country | Vulnerability Index | Country Ranking |
|--------------------|----------------------------|------------------------|
| Albania | 0.263 | 50 |
| Argentina | 0.077 | 81 |
| Australia | 0.141 | 71 |
| Austria | 0.166 | 67 |
| Bangladesh | 0.240 | 53 |
| Barbados | 0.549 | 12 |
| Belgium | 0.294 | 42 |
| Belize | 0.588 | 7 |
| Bolivia | 0.229 | 56 |
| Brazil | 0.001 | 86 |
| Cameroon | 0.304 | 41 |
| Canada | 0.089 | 78 |
| Chile | 0.290 | 43 |
| China | 0.000 | 87 |
| Colombia | 0.194 | 62 |
| Costa Rica | 0.334 | 37 |
| Cote d'Ivoire | 0.401 | 26 |
| Croatia | 0.368 | 31 |
| Cyprus | 0.643 | 5 |
| Czech Republic | 0.236 | 54 |
| Denmark | 0.311 | 40 |
| Dominican Republic | 0.588 | 8 |
| Egypt, Arab Rep. | 0.504 | 15 |
| El Salvador | 0.277 | 47 |
| Estonia | 0.695 | 4 |
| Finland | 0.219 | 60 |
| France | 0.099 | 77 |
| Germany | 0.076 | 82 |
| Greece | 0.501 | 16 |
| Honduras | 0.409 | 24 |
| Hong Kong, China | 0.546 | 13 |
| Hungary | 0.225 | 58 |
| Iceland | 0.465 | 19 |
| India | 0.154 | 70 |
| Indonesia | 0.133 | 75 |
| Iran, Islamic Rep. | 0.389 | 28 |
| Ireland | 0.284 | 44 |
| Israel | 0.339 | 36 |
| Italy | 0.062 | 83 |
| Jamaica | 0.706 | 3 |
| Japan | 0.081 | 79 |
| Jordan | 0.555 | 10 |
| Kenya | 0.391 | 27 |

| | | |
|---------------------|-------|----|
| Kuwait | 0.560 | 9 |
| Latvia | 0.550 | 11 |
| Lithuania | 0.357 | 32 |
| Luxembourg | 0.471 | 18 |
| Madagascar | 0.356 | 34 |
| Malaysia | 0.449 | 21 |
| Malta | 0.765 | 1 |
| Mauritius | 0.484 | 17 |
| Mexico | 0.035 | 85 |
| Morocco | 0.208 | 61 |
| Nepal | 0.250 | 51 |
| Netherlands | 0.279 | 45 |
| New Zealand | 0.245 | 52 |
| Nicaragua | 0.442 | 22 |
| Nigeria | 0.518 | 14 |
| Norway | 0.416 | 23 |
| Pakistan | 0.267 | 49 |
| Panama | 0.640 | 6 |
| Papua New Guinea | 0.389 | 29 |
| Paraguay | 0.227 | 57 |
| Peru | 0.186 | 64 |
| Philippines | 0.371 | 30 |
| Poland | 0.134 | 74 |
| Portugal | 0.185 | 65 |
| Romania | 0.158 | 69 |
| Russian Federation | 0.184 | 66 |
| Senegal | 0.355 | 35 |
| Singapore | 0.743 | 2 |
| Slovak Republic | 0.273 | 48 |
| Slovenia | 0.235 | 55 |
| South Africa | 0.113 | 76 |
| Spain | 0.192 | 63 |
| Sri Lanka | 0.318 | 39 |
| Sweden | 0.159 | 68 |
| Switzerland | 0.136 | 73 |
| Thailand | 0.278 | 46 |
| Trinidad and Tobago | 0.408 | 25 |
| Tunisia | 0.326 | 38 |
| Turkey | 0.140 | 72 |
| Uganda | 0.457 | 20 |
| United Kingdom | 0.081 | 80 |
| United States | 0.046 | 84 |
| Uruguay | 0.221 | 59 |
| Venezuela, RB | 0.356 | 33 |

Source: Briguglio and Galea (2003)

**Figure 1
The Four Scenarios**



**Figure 2.
Risks Associated with being Adversely Affected by External Shocks**

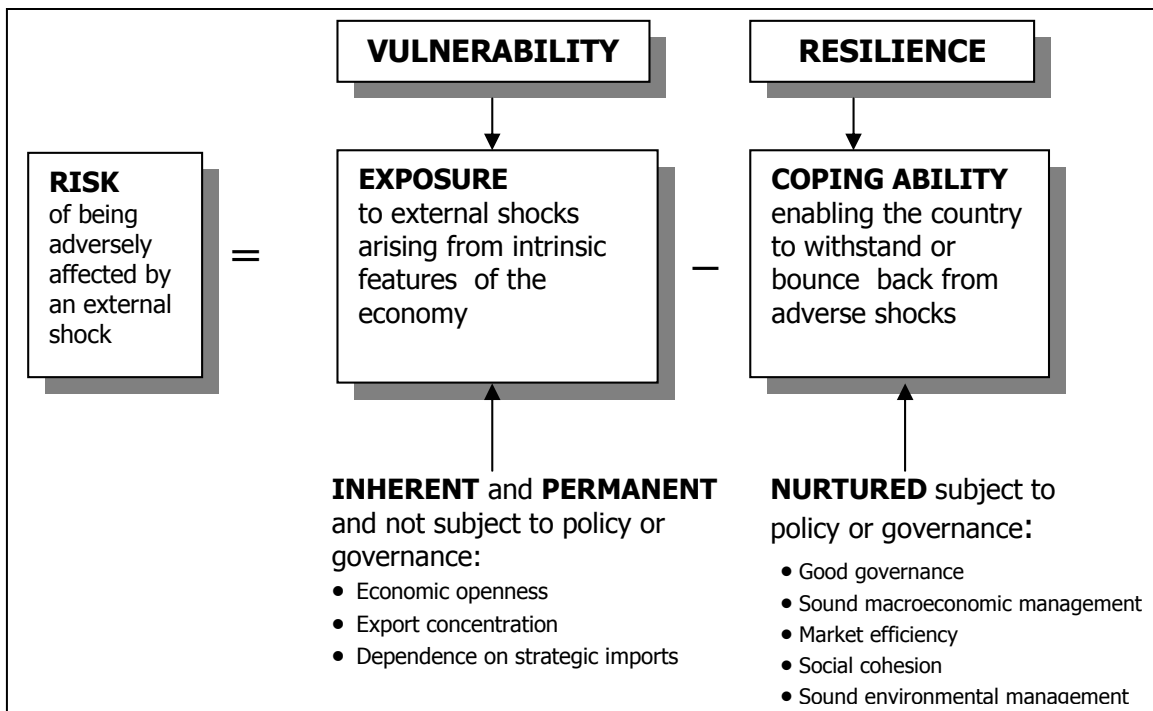


Figure 3
Per Capita GDP and Economic Resilience

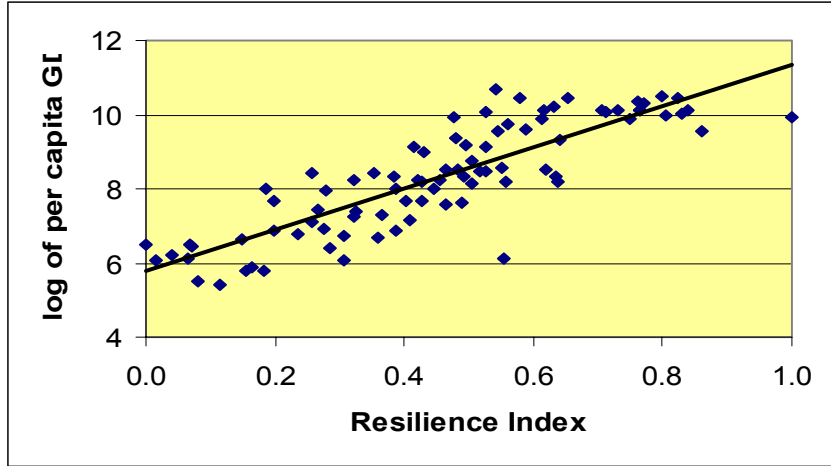


Figure 4
Economic Resilience and Economic Vulnerability

