1. The political economy of small states in Europe

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STATES IN HISTORY

History has known many different types of polity, to use the neutral term that Ferguson and Mansbach (1996) employ to avoid the loaded connotations of 'state'. These have evolved and changed according to changing international and domestic circumstances. Over much of European space and history the dominant mode of rule has been the empire, from the Roman and Byzantine, through the Holy Roman, to the Habsburg, Ottoman, Romanov and Hohenzollern empires, the last three enduring until the First World War. Empires are characterized by a concentration of military power at the centre but diverse means for ruling the periphery, including direct control and the use of intermediaries. There is no need for a homogeneous culture, national identity or unified institutions.

In the western part of the continent, the end of the Roman Empire saw a fragmentation of political authority, followed by the rise of states (Rokkan 1999). During the fifteenth century, large polities consolidated, while several smaller projects failed (Burgundy, Catalonia, the Lordship of the Isles). Other polities survived at the interface between the powers. Scotland played England against France for centuries and survived despite the weakness of its monarchy. The Netherlands emerged in the context of war between England and Spain. Stein Rokkan (1999) drew attention to the 'shatter-belt' of territories that maintained their identities. The Netherlands, born from a religious revolt in a group of varied provinces in the sixteenth century, developed into a strong and unitary state. Belgium split away in 1830, only itself to experience territorial tensions in the late twentieth century. Finland emerged from successive Swedish and Russian overlordship, while the Baltic states emerged twice during the twentieth century.

During the eighteenth century, there was some consolidation of the state system, continued into the nineteenth century with the 'unification' of Germany and Italy and the integration of France. Nationalism served the cause of larger units in Germany, Italy and France. In central and eastern Europe, on the other hand, it was a factor in disintegration of empire and the creation of smaller units.

The nation-state was not inevitable, and it faced many competitors (Spruyt 1994). Nor did a single model of nation-state emerge in Europe. Different sizes of states do, however, face distinct challenges at particular historical moments. There are varied explanations for these trends. Some studies emphasize force and the strategies of leaders seeking to control the maximum territory (Tilly 1975). Changing military technologies featured, as the need for large standing armies and weaponry from the nineteenth century privileged large states. Previously, small polities could mobilize their own military power (as with the Venetian navy and arsenal), but otherwise troops could be purchased. Some explanations are more sociological, emphasizing communication, cultural integration and the rise of nationalism (Deutsch 1966). Dynastic marriages, the strategies of state-building elites and opportunism played a role.

This chapter focuses on economic factors and the way they condition the size of states. It is important here to avoid any functional determinism or teleology, since there is no automatic process that aligns the size of states with economic optimality. Tilly (1990) has noted the combination of economic and military factors (capital and coercion) as interacting in the construction and consolidation of states. So we might say that prevailing economic circumstances and trading orders condition the choices of state leaders, providing constraints and opportunities, but that the size of states themselves is the product of a combination of the factors outlined above.

In the early modern period, small polities such as Venice, Genoa, Rijeka and the Hanseatic cities, along with the provinces and cities of Flanders, were located on trade routes (Tilly 1994). Other polities survived at the periphery of the state system, as in Scandinavia, or turned towards global empire, as did Portugal. During the nineteenth century, economic development and industrialization pointed to the need for larger internal markets, although this was rarely simple. German unification was preceded by a free trade area and itself deepened economic integration. The creation of a single market in Italy, however, was less of a success, bringing together units whose role in the international trading order was very different, often defying economic logic. The aftermath of the First World War saw the triumph of the nation-state model in Europe, but this was not the product of economic logic. On the contrary, it broke up integrated markets in parts of Europe such as the Danube basin and was followed by a retreat to national protectionism in the 1930s.

THE ADVANTAGES OF BEING BIG

During the twentieth century, it was often assumed that large states represented the future because they were functionally more efficient. At a time of expanding industry, it helped to have a large internal market and a wide range of productive activities. Having a large and diversified internal market can help a country to weather 'asymmetrical shocks'. Larger states were also credited with economies of scale, in overseas representation, domestic administration and defence and in expensive items like research and development. Small states were vulnerable to external economic shocks and to predatory behaviour, including beggar-my-neighbour economic protectionism.

When the world trading system collapsed between the two world wars, small states were particularly badly hit, forced back on their own restricted domestic markets. The advantages of scale seemed to increase after the Second World War, when governments accepted responsibility for economic management including full employment, economic growth, price stability and regional balance. Keynesian macroeconomic management was best managed at a large scale, with central governments mobilizing resources; the danger, in a small country, is that the benefit will leak abroad on imports. Gradually, Keynesian macroeconomic policy was complemented with an active government role in sponsoring 'national champions' in key economic sectors, and engaging in various forms of indicative planning in conjunction with the private sector.

The welfare state in the twentieth century also favoured big states. Welfare rights were rooted in a common political community, which was assumed, without a great deal of analysis, to correspond to the nation-state, which in turn was both an administrative unit and a community of belonging. It seemed logical that large states would be better at welfare, as they could mobilize larger resources across large geographical spaces. There were explicit mechanisms for transferring resources to local governments on the principle that rich and poor regions should be able to provide the same level of services irrespective of fiscal capacity. If national solidarity was strong enough, such transfers could even be permanent rather than sporadic, the price paid for national unity. Decentralization of taxes and welfare, on the other hand, might lead to a 'race to the bottom' as poorer polities cut taxes and services to attract business investment. Welfare states were thus a centralizing influence and both drew on and in turn strengthened a sense of common destiny and solidarity.

Finally, in an uncertain and dangerous world, size seemed to offer a degree of protection against aggression. Only large states could afford large armies, navies and the modern military technology of the late-nineteenth- and early-twentieth-century arms races. Small states might rely on international guarantees, but these were often swept aside, as happened to Belgium in 1914. The fate of Czechoslovakia in 1938 showed that even their supposed protector could connive in their destruction. Since the Congress of Vienna in 1815 it had been the big powers that disposed of the affairs of the continent, including recognition of states, installation of monarchs and any moving of boundaries. Intellectual cover was given to great power pretensions by the geo-politics school of geographers, who believed that nations had destinies determined by their geographical location and strategic interests. Influence stemmed from size, resources and command of land or the seas, while the great powers struggled for supremacy.

GLOBALIZATION AND THE END OF THE STATE?

During the 1990s, the debate about 'globalization' posed the question of whether the nation-state itself had been superseded. International trade flows made the idea of national economies meaningless. Free movement of capital could overwhelm efforts by governments to manage their currencies. Transnational corporations could shift investment and production at will, so forcing national governments to meet their demands on taxation and regulation. Keynesianism was no longer viable in an open economy where any stimulus would leak away. A cultural version of globalization refers to the rise of global culture based on mass consumerism. The information revolution was another contributing factor, with trade in goods giving way to information and instant communications breaking down national borders.

In retrospect, all this talk of globalization and the end of nations and states proved overblown. It is true, however, that the freedom of action of nation-states has been circumscribed by economic forces over which they have ever less control. States with their own currencies are vulnerable to speculative attacks. States with high taxes on companies and wealthy individuals may risk losing investment and a tax base. As capital and production could so easily be moved around it became ever more difficult to tax corporations at all. The result was a gradual reduction in corporate taxation and a blind eye to corporate tax avoidance.

National welfare states can be undermined by the unbalancing of social relationships under globalization. They were built on social compromises between capital and labour in a situation in which neither had an 'exit' option and were obliged to accommodate each other. If capital and highly skilled workers can now move around while the rest of the labour force is immobile, there is less incentive to come to these agreements. Multinational firms, in particular, are often known for their anti-trade union attitudes and unwillingness to engage in broader bargaining. So the decline of trade unions has been linked to the internationalization of the economy and a division between workers in more or less globalized sectors. This in turn has unbalanced the domestic political compromises between capital and labour that underpinned the post-war welfare state.

If all states were impotent in the face of globalization and competitive imperatives then *a fortiori* small states should be even more disempowered and vulnerable. They are even less able to master global forces, to balance their economies or to resist external pressure. Lacking large internal markets, they must export and accept the disciplines of the global economy. Yet, from the late twentieth century, a literature emerged arguing that small states might actually possess some advantages in a global era. Quantitative comparative analyses suggested that they did no worse, and often did better, than large states on most economic and social indicators (Katzenstein 1985; Armstrong and Read 1995, 1998; Easterly and Kraay 2000; Skilling 2012a). Attention also turned to the new states that were emerging following the collapse of the Soviet Union and Yugoslavia. Globally, states have proliferated, and the United Nations currently has 193 members, against 154 in 1980.

THE RETURN OF SMALL STATES

Global and European free trade reduces the capacity of states to manage their economies in the old way, but for small states it can be liberating. They no longer need large domestic markets, since the home market is now the whole of Europe or even the world. International rules protect them by outlawing protectionism and trade barriers and preventing large states bullying them or unilaterally changing the rules.

The same argument can be made about defence and national security. Collectivization of security under NATO and other transnational bodies reduces threats from neighbours as well as more remote powers. It eliminates the need for autonomous national defence or costly armaments across the whole spectrum. Small states have adapted to this in various ways (see Chapter 2). Some, such as Denmark and Norway, joined NATO, while Austria was neutral by international agreement. Finland was neutral but with a care not to provoke the Soviet Union, while Sweden practised armed neutrality. Ireland was formally neutral, for historical reasons, but not politically impartial between East and West and was able effectively to free-ride on Western security, since the Western powers would not allow it to fall into the hands of their enemies. All these countries effectively sheltered under the umbrella of NATO, which prevented wars within the Western sphere. Strategic security, in turn, allowed small states to seek their own place in the global division of labour.

Alesina and Spoloare (2003) argue that global or continental free trade actually produces small states. That is a piece of functional determinism and does not correspond to the historical facts. In fact, most small states are the result of decolonization or, in Europe, the fall of empires, including the Habsburg, Ottoman and Russian empires after the First World War and the Soviet Union in the late twentieth century, and had nothing to do with free trade. Economic considerations hardly featured in early-twentieth-century debates about independence, which were driven by nation-building and identity politics, and nationalists tended to be economic protectionists (Bohle and Greskovits 2012).

It is more accurate to say that free-trading conditions may provide new opportunities for small states, as well as vulnerabilities. Deprived of many of the classic mechanisms of macroeconomic management and unable to control international markets, small states must adapt. They are, in many ways, policy-takers rather than policy-makers (Skilling 2012a). The key issue here has become that of national competitiveness. This is a difficult and contested idea. Since the demise of mercantilism, the dominant theory about the international division of labour has been that of Ricardian comparative advantage. This suggests that global welfare, as well as that of individual states, will be maximized when each specializes in what it does best. Authors like Porter (1990), in *The Competitive Advantage of Nations*, argue that comparative advantage (under which every state has its own niche) has now given way to absolute or competitive advantage. As Porter (1990, p. 8) puts it, ‘exposure to international competition creates for each industry an absolute productivity standard necessary to meet foreign rivals, not a relative productivity standard compared to other industries within its national economy’. Ohmae (1995) and Alesina and Spoloare (2003) go further, to argue that the size of the state itself is determined by the exigencies of competition and that this explains the re-emergence of small states in the contemporary era.

This is another instance of functional determinism. Moreover, many economists also argue that national competitiveness is meaningless, since only firms compete (confusingly, Porter 1990 also argues this at one point, p. 33). The idea must therefore be seen as much as a political construction as a fact and one that has a strong ideological component. Whatever its merits, however, it has been embraced by states and international organizations. The European Commission has preached a relentless message about competitiveness not only among states but among regions as well.

Of course, since competitiveness is always measured in relation to one's competitors, it is impossible for all states to become more competitive at the same time, as opposed to becoming more productive.

Porter, Ohmae and Alesina and Spoloare are at one in arguing that adaptation to global markets requires neo-liberal policy responses, which they present as both necessary and desirable. An earlier literature, however, had drawn rather different conclusions. Small states tended to be open economically, seeking global markets to compensate for their small domestic ones, and supporting trade liberalization (Katzenstein 1985). On the other hand, they tended to have rather large public sectors and high taxes. Rodrik (1998) attributed this to the needs of economic stabilization. While large states could mobilize resources over a larger space and recover from downturns more easily, small states were more vulnerable to economic fluctuations, which a larger public sector could help to cushion. Many of them focused on specialized types of production in which economies of scale are less important than in the basic industries of the old industrial era. In defiance of the 'race to the bottom' hypothesis, large states were not better at welfare and distribution than smaller ones. On the contrary, the most generous welfare provision and the highest levels of public services are found in some of the smaller states. So there is not one small-state model of adaptation to global change but several. Here we summarize them under two ideal types, the market liberal and the social investment models, to show that small states do have policy choices, even if these are constrained.

THE MARKET LIBERAL MODEL

The market liberal mode of adaptation accepts the logic of global competition and the corollary that states are policy-takers. This implies keeping production costs low and catering to mobile investment capital, skilled workers and professionals. Measures include reductions in business regulations, low taxes on business and high earners, and flexible labour markets and wages. The public sector generally is seen as a charge on the productive economy and so should be small. The ideal type also includes free movement of labour so that in bad times workers can migrate while in good times they come back. The market liberal strategy of going with the economic flow entails accepting economic cycles and the 'creative destruction' they can bring and concomitant rises and falls in income. It is marked by sharp inequalities in income and wealth, as those in internationally competitive jobs and sectors can command a premium.

New Zealand embarked on a market liberal experiment in the 1980s after it had lost a large part of its export market when the United Kingdom joined the (then) European Economic Community and its protectionist industrial strategy became unaffordable (see Chapter 10). The strategy has been applied in the Baltic states, where it is presented as a logical part of the transition to the market economy. Trade unions there are weak, and workers and the general public more tolerant of sharp changes in their material conditions, given their recent experiences (Bohle and Greskovits 2012). Enlargement of the European Union has provided opportunities for out-migration when jobs are scarce and to return when times are better.

It is difficult to reproduce these policies in mature European welfare states, where public services are seen as a permanent social gain and cannot easily be dismantled. Trade unions are still part of the national life, however weakened in recent decades. Voters will not easily tolerate sharp fluctuations in living standards without social and political instability. Taxes on businesses in Europe have been driven down by international competition, with new EU member states having some of the lowest levels, but small countries do not appear to be especially vulnerable to this (Elschner and Vanborren 2009).

The market liberal strategy is open to objections that it is ineffective even on its own terms. Studies have questioned the effectiveness of low corporation taxes in attracting industrial investment (Jensen 2012). The cases of Ireland and central and eastern Europe may be distinct, since they adopted low corporate taxes at a time when there was little private domestic industry and little existing revenue to lose. Marginal differences in taxation appear to be rather low down the list of criteria for choosing investment locations, compared with skilled labour, infrastructure and other locational characteristics. Tax cutting encourages 'brass-plate' relocations and transfer pricing, whereby profits are declared in the low-tax jurisdiction but production is done elsewhere. Tax cutting can also set off a tax competition in which small states may ultimately lose out.

There is now a lot of evidence that inequality, far from stimulating economic growth, may be a drag on performance (Wilkinson and Pickett 2010; Stiglitz 2012; Ostry et al. 2014). Public services are not just a burden on the productive economy but may provide the physical and human capital on which private production depends, especially in advanced economies. Small states may be even more in need of these public goods, as they lack the large private corporations which might invest heavily in research and development. As a consequence, publicly funded and university research is vital.

While small states often have high foreign direct investment (FDI), this can also create vulnerabilities to external changes and decisions taken elsewhere. There may be a loss of diversity, and the FDI sector can become detached from the domestic economy, trading in global markets and generating profits but without spreading the benefits back. Small local firms may find difficulty in competing with multinational enterprises able to offer higher wages for the most skilled workers and mobilizing huge resources for investment. This can create an economic dualism between a foreign-owned sector effectively able to set its own rules and a weaker and vulnerable domestic sector, as in Ireland.

THE SOCIAL INVESTMENT STATE

An alternative conception is that of the social investment state (Crouch 2013; Hemerijck 2013), in which public expenditure is seen not as a drain on the productive economy but as part of it. So education represents investment in human capital, while health spending can enhance productivity. Research is a contribution to innovation and economic renewal. Publicly financed childcare allows mothers to remain in the labour market, so expanding the workforce and retaining skills. Investment in the early years of childhood contributes to economic prosperity, improving skills while reducing the later burden of social marginalization.

Social investment implies not just sustaining public expenditure but redefining it and shifting the priorities towards efficiency-enhancing measures. There is now a broad consensus that the most effective way of tackling deprivation and other social problems is to get people into work, but sharp differences on how it might be achieved. While neo-liberals favour punitive approaches to unemployment, by reducing welfare benefits and imposing strict requirements, the social democratic approach privileges preparation. So active labour market policy, seeking to align training, benefits and economic development, has become central to policy debates. This is consistent with modern ideas about supply-side measures as the key to economic success, given the limitations of states, and especially small states, to engage in traditional Keynesian economic management or, within currency unions like the Euro, to use monetary policy to regulate demand.

It is also consistent with the move within welfare policy, away from the male breadwinner and the family facing predictable lifetime challenges, towards a more complex society in which gender and age, as much as class, structure the labour market. There are 'new social risks' which include precarious and low-paid employment and marginalization of under-prepared workers. The old model was based on insurance against the contingencies of life, which would balance out in due course. Unemployment was seen as cyclical so that national insurance funds could accumulate in boom times and be drawn down in recessions. Old age pensions were built up in the working years and consumed after retirement at a fixed age. Whether in the form of investment funds or as obligations on the part of the state, they represented claims on future production, which was generally assumed to be ever-increasing. In the new way of thinking, there are multiple types of household and routes into employment. There is also a need for continually upgrading skills to meet new technologies and modes of production.

Social investment thus stated appears to reconcile otherwise competing priorities between economic competitiveness and social welfare. Indeed, it can look like a magic formula to escape from one of the central dilemmas of public policy. Education both improves the economy and aids social mobility by giving people from poorer backgrounds the opportunity to prosper. Health spending has both economic and social benefits. Active labour market policies help individuals out of poverty and increase the productive labour force at the same time. Reskilling and training can ease the transition into high-productivity activities and so raise wages. If more equal societies are indeed more productive, then again the social and economic imperatives can be reconciled. The formula might have particular appeal to small states, for which the dilemma between national competitiveness and social cohesion is especially acute, given their market vulnerability. It is not surprising that social investment has had particular appeal to social democrats as they seek to adapt their policies to the modern age. Trade unions have welcomed the emphasis on human capital enhancement.

In practice, matters are more complex. The phrase 'social investment' may amount to little more than a way of legitimizing public services at a time of financial constraint and neo-liberal hegemony. It often seems to subordinate the claims of social justice and equality to those of the economy. By focusing on productive labour, it might favour the better-off or those who could most easily be brought into the workforce (Rhodes 2013). The stress on new social risks might be exaggerated, since the old social risks have not gone away. Preparation and job training are not going to get people into work if there are not enough jobs available.

A social democratic version of the strategy is marked by an emphasis on social equality for its own sake. As social inequalities rise as a result of the new international division of labour, it is difficult to tackle them through taxes and benefits alone, hence the interest in enhancing human capital. Spreading the benefits, however, still requires the right kinds of domestic institutions, including labour markets and collective bargaining. Social investment is a long-term strategy, and citizens must defer consumption and immediate gratification in favour of the long term, while the present generation needs to think of future ones. It implies higher taxes. Given the volatility of taxes on high earners and their propensity to migrate, taxes need to be broad and weigh also on the middle classes. Politically, this is sustainable only when all citizens feel that they benefit from the public services financed. This explains the tendency in the Nordic countries to universal rather than selectively available public services, so binding in the whole population to the social contract. Social justice is assured by providing the same level for rich and poor rather than by explicitly redistributive tax policies.

Some states have a better starting point than others. Some legacies go back to the nineteenth century, while others date to historical crises and social compromises in the twentieth. The Nordic states had crucial experiences in the inter-war period, which shaped institutions and expectations in the longer run. Even among the transition states of eastern and central Europe, emerging from Communism, some were better placed than others because of historic legacies or because they had started to adapt even before the Berlin Wall came down (Bohle and Greskovits 2012).

In the next two sections we consider the institutional and cultural conditions for building different forms of response to these external vulnerabilities.

CORPORATISM AND CONCERTED ACTION

In the 1980s, Katzenstein (1985) identified the secret of adaptation of small states to global markets as corporatism, a mode of policy-making in which government, business and trade unions get together to thrash out agreements on long-term goals and commitments (Schmitter 1974). Coordination can thus overcome problems of collective action and benefit both sides. Unions accept nominal wage restraint and thus contain inflation and business costs, in return for full employment and increases in real wages. They may accept lower individual wages in return for enhancement of the 'social wage' in the form of public services such as health and education. Business commits to investment in the knowledge that markets will expand, wages will be under control and infrastructure will be provided. Government agrees to fund public services and expand infrastructure, relying on other partners to deliver and thus sustain the tax base. Corporatism may be used in good times to control booms, and in crisis to recover production levels without massive unemployment. While corporatism was not confined to small states it may be that their vulnerabilities make it more attractive, while their size makes it feasible. In its classic form, however, it depended on certain preconditions.

One is the existence of domestically owned businesses with a stake in the prosperity of the country and unable to relocate easily. Locked in by national boundaries, they had an incentive to cooperate with the other social partners to produce public goods. While neo-liberal economists regard all firms as following a single capitalist logic, sociologists have often drawn attention to different models of capitalism (Hall and Soskice 2001). In liberal market economies, firms compete with each other according to individualistic market principles. They typically aim to maximize profits in the short term and, nowadays, the value of their shares. In coordinated market economies, on the other hand, business is organized in associations, which regulate their own affairs and cooperate (as well as competing) to produce public goods from which they can all benefit, such as skilled labour. Firms look to the long term and often aim at increasing market share and expanding production, rather than maximizing profit in the short term. Such firms are more likely to be amenable to corporatist bargaining and collective action.

A second condition is strong and centralized associations representing business and labour. These can control their own members and come to agreements, knowing that they can deliver. Finally, corporatism needs a strong government, able to tax and spend effectively and to deliver on its commitments. Corporatist arrangements are often combined with proportional representation, which ensures that a wide spectrum of political opinion is incorporated in decisions.

The central feature of corporatist bargaining has often been national wage negotiations, conducted by employers and unions, sometimes with a role for the state. This secures a basic agreement on the distribution of the social product, with universal trade unionism ensuring that wage differentials are not excessive. On top of this are built a variety of other elements, including the 'social wage', commitments to public investment and measures to meet the needs of particular groups within the community.

By the 1980s corporatism appeared to have declined as a result of globalization and the opening of markets (E. Jones 2008). The idea of national capitalism made little sense in a world dominated by global corporations and mobile investment. Trade unions were in retreat, especially in the private sector and in multinational corporations. Rising welfare costs meant that governments could not continually increase the social wage but rather sought containment and retrenchment. Economic problems in coordinated market or corporatist states were attributed to the sclerosis brought on by having to negotiate change and allowing declining sectors a veto on innovation. From being the secret of success, corporatism became the scapegoat for failure.

Corporatism was never confined to small states but was particularly important to them, given their need to adjust to global markets without provoking excessive social divisions or unsustainable levels of unemployment. It has proved most enduring in Norway, in Belgium and in Austria. In

Sweden it has largely been abandoned in favour of market adjustment, although the strength of trade unions means that the ideas of compromise have not totally vanished. The Netherlands moved from corporatism to a looser form of coordination labelled the 'polder model'. Ireland moved towards concerted action in the 1980s but abandoned it in the economic crisis of the late 2000s. The experience of the transition states of eastern and central Europe has been highly diverse. The Baltic states embarked on a market liberal strategy from the outset, especially in Estonia. Slovenia, in contrast, practised neo-corporatism with a significant role for trade unions (Bohle and Greskovits 2012). In the Visegrad countries (Poland, Hungary, the Czech Republic and Slovakia), social concertation was tried but never quite worked out and was eventually abandoned.

In the 1990s, however, a number of European states came back to negotiation among the social partners in an effort to regain competitiveness and to qualify for the single European currency through what Martin Rhodes (2001) called 'competitive corporatism'. This was not the full corporatism of old, with binding agreements among peak groups, but described as 'lean corporatism' (Traxler 2004), 'social concertation' (Compston 2002), 'social pacts' (Avdagic et al. 2011), 'social dialogue' or 'social partnership'. The European Commission has promoted the idea, emphasizing social investment and economic theories that incorporate human capital, research and entrepreneurship.

Wage negotiation, to sustain international competitiveness, often remains at the core of these social bargains. They can provide business with knowledge of future costs, thus encouraging investment. Training and active labour market policy are linked to competitiveness and sometimes go beyond individual wages to the social wage, public services and welfare. There is some tendency to escape the old corporatist insider deals by extending partnership to other groups, including social interests, the voluntary sector and environmentalists. Business interests however have the biggest influence, while unions occupy a less central position, and social and environmental interests come still further behind.

Large business and multinational firms tend to stand aside from social partnerships, but they still benefit from wage stability, public services and trained human resources. In some countries, vocational training is entrusted to partnerships of employers and unions and financed from business levies, which provides a disincentive to free riding and a motive for participation. Small businesses are often not organized in effective associations – sometimes they have to work within bodies dominated by the big firms, and are unable to make their voices heard. It is medium-sized enterprises that often have the most to gain from social concertation, tied as they are into the national system and needing support that big firms can provide for themselves. Accordingly it works most effectively where there is such a tier of firms.

Social concertation is more flexible than classic corporatism. There is scope to change plans if external circumstances change. Rather than a single set of peak negotiations, there may be multiple venues for concertation and negotiation, reducing veto points and blockages, while providing incentives for cooperation; an issue blocked in one negotiating forum can be taken elsewhere. Sometimes it is very lightly institutionalized, but, even where formal partnership bodies have been disbanded, the idea of negotiation and compromise persists. Where a crisis hits, there may still be a tendency to organize a summit or social partnership. In this way, the shadow of corporatism survives its formal demise, and the search for consensus continues.

Small states can respond more or less effectively to vulnerabilities by institutional adaptations, but this still raises the question of why and how this is done. It may be that small size in itself fosters positive forms of adaptation, but this might be argued either way. Alternatively, the secret may lie in culture or in historically ingrained patterns of behaviour.

DOES SIZE MATTER?

Small states may have advantages in adaptation in that their leaders, whether in government, business or civil society, know each other personally, and there are short lines of communication. The relevant people can gather in one room to sort out deals. There may be less social distance between groups and a sense of shared destiny. External challenge may foster a habit of working together and a sense of social cohesion and encourage trust.

On the other hand, small states, where everyone knows everyone else, could be risk-averse and prone to group-think. The need for consensus could stifle innovation and creativity. Vested interests could be stronger, and domestic producers could be in a strong position to demand protection and support of various sorts, and so inhibit economic change and dynamism. The very closeness of actors may encourage rent-seeking, in which groups each try to enlarge their own share of the social product rather than expanding the total. Outdated and uncompetitive sectors may exercise undue influence.

There is also a danger of clientelism, a mode of government based on doing favours for individuals and small groups and distributing resources in small packages. This avoids large issues, prevents resources being applied where they can produce the largest social benefit and discourages long-term planning. Clientelism may thrive in small societies where people know each other and reputations are important. In larger states, the population is so large that politicians are unable to bribe them all. It follows, therefore, that the patterns of behaviour themselves matter.

CULTURE

Since the 1980s there has been a debate about social capital as a third factor of production alongside physical and human capital (Coleman 1988; Portes 2001). It refers to the ability of societies to sustain virtuous patterns of behaviour, including non-simultaneous reciprocity, that is contributing to the common good in the knowledge that the individual will gain in the longer term. This contrasts with market exchange, in which there is a simultaneous exchange, and with patrimonial systems, in which there is a non-market exchange of favours. A central element in social capital is trust, especially trust in people whom we do not know personally. Studies have regularly shown high levels of such trust in the Nordic states (Marien 2011). The concept of social capital was popularized by Robert Putnam (1993) in a study of Italy purporting to show very different levels of social and economic performance in different regions. Putnam's work has been subjected to some devastating criticism on both methodological and empirical grounds (see the special issue of *Politics and Society*, **24** (1), 1996) but remains influential, since it appears to offer policy-makers the holy grail of a combination of economic prosperity and social cohesion. The main problem with the way the concept has been used is in its operationalization and measurement. Typically, there are surveys of individuals asking them about attitudes and levels of trust, drawing on the 'civic culture' tradition (Almond and Verba, 1965, 1980). Social capital, however, is essentially about relationships, which are mediated by institutions and circumstances. Putnam attributes the differences among Italian regions to history going back to the Middle Ages,[1] but historians have shown that societies regularly undergo changes in their self-understanding and that they can sometimes shift radically in short periods of time (Plumb 1967).

Alesina and Spoloare (2003) also tend to a reductionist view of culture and attitudes. They start from public goods theory, to argue that smaller states will better serve their citizens by giving them policies that they like. Small states are more desirable because, with a smaller population, their citizens are more likely to have the same preferences for public policies. In fact, this does not follow, since there is no reason to think that a population of 5 million people is more likely to agree among themselves than one of 50 million. Some of the smallest polities are deeply divided. Alesina and

Spoloare (2003), however, back up their argument by assuming that small regions and countries will be more ethnically homogeneous. As they put it, 'in today's world of free trade, relatively small ethnic regions can "afford" to stay small and homogeneous' (2003, p. 14). Ethnicity is a highly problematic concept, and sociologists these days are practically unanimous that it is socially constructed. Individuals have multiple identities, which they use for different purposes (class, gender, nationality or age, for example), and share these differently with different other people. In so far as ethnicity can be measured, it is as a compound of other characteristics including language, religion, subjective feelings and intersubjective meanings, which are always contested and always changing. Race, a term that Alesina and Spoloare also use rather freely, is even more problematic. Biologists are agreed that it is not a scientific category. It is rather a sociological category, in which an arbitrary characteristic like skin colour is used to unite people who are otherwise highly varied and to differentiate them from others. Nations are socially stratified societies, with rich and poor, employers and workers and a host of other divisions. Social concertation and negotiation happen not because everyone has the same preferences and interests but precisely because they do not and must therefore arrive at positive-sum compromises.

Culture in itself does not, therefore, explain very much and ethnicity even less. In fact, the cultural stereotypes that are invoked to explain success and failure of social projects are usually merely rationalizations of the outcome rather than real causes. Often the same qualities are invoked to account for success at one time and place and for failure at another (Keating et al. 2003; Keating 2008). So individualism can be presented as an entrepreneurial virtue, to explain success, or as a lack of social capital and cooperation, to explain failure. Collectivism and a sense of community can be presented as social capital or as a lack of entrepreneurial spirit. A strong sense of tradition can be spun as evidence of being trapped in the past or as the basis for community and social capital. Cultural homogeneity can be invoked to explain common purpose, but cultural diversity can equally be used to explain innovation. It is not, therefore, embedded cultural characteristics of society that explain the capacity for adaptation but the way that cultural images and traditions are pressed into service to underpin a project.

A different and more sociologically informed idea of trust rejects both essentialist arguments based on shared ethnicity and purely individualist accounts. Instead, it looks at relationships, examining what Sabel (1993) calls 'studied trust', the emergence of effective common purposes and trust as a result of experience. It is not necessary for everyone to share the same beliefs and values as long as they share the same political space and engage in compromises and cooperation. In this way, individual short-term interest can be linked to the pursuit of mutual shared interests.

The past matters, since it leaves a legacy of policies and institutions, which cannot always be changed overnight. History, however, is no more determinate than other social and economic circumstances, and small states can adapt to changed conditions. What the path dependency theorists often neglect, moreover, is that history is as often the product of the present as its cause, continually revised and reinterpreted to make sense of the present, whether in a positive or a negative sense. The national imaginary is thus a compound of what happened and how it is interpreted. Small nations faced with big neighbours may be particularly attached to their national myths and, while these are not objective reality, they are important elements in the construction and reproduction of the polity.

PATHS TO ADAPTATION

Small states are vulnerable to external economic shocks in the modern interdependent world. On the other hand, they may have offsetting advantages that allow them to adapt to external change and provide themselves with some room for manoeuvre. This is not because of any determinist relationship between global trading conditions and state size, nor because of embedded and immutable cultural traits. Nor is it true to say that small states can always adapt better, still less that the demands of the modern interdependent world have actually brought small states into being. It is rather that small states have experienced different ways of managing the interactions of global markets with local institutions and politics. There is no one model for success but rather multiple modes of adaptation. This does not mean small states can adopt any policy mix they choose, since there is a complementarity among policies in different fields that can ensure that they are mutually sustaining. The experience of Ireland illustrates the problems that arise when seeking to combine different modes of adaptation (Dellepiane and Hardiman 2012). Once set on a particular path, however, it is often difficult for states, locked into particular modes of policy-making, to change. Doing so may leave them particularly vulnerable to external shocks and pressures, as the experience of the transition countries of eastern Europe shows.

NOTE

1. History, to put it charitably, is not his strong point.