

What Is a "Small State" in a Globalizing Economy?

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ABSTRACT

Globalization delineates the definition of a "small state" from objective markers of size. After a brief review of previous definitions of small states, this article focuses on the growing influence of "smartness" or "innovation" determining the "size" of states in times of globalization. The influence of globalization through the most prevalent trends – the increasing openness of economies, the internationalization of technology, the emergence of global production networks and the growing influence of multinational corporations – is explored as this article tries to shed some light on the concept of "size" in the 21st century. In the course of an extensive literature review, this article reaches the conclusion that the economy structure, developmental level and geography (core-periphery relationships) play a decisive role in the real "size" and development of states.

Key Words: small states, innovation, globalization, size of states, development.

1. Introduction

Economist Paul Streeten (1993) has written that "we know a small country when we see it." Indeed, no one debates the existence of small states, but scholars have very different ideas of what the definition entails. During times of increasing economic globalization one might ask: what is small in the 21st century? This article will try to answer the question by an extensive literature review. A synthesis of relevant theoretical and empirical studies is provided for this theoretical précis.

Today, globalization is a manifestation of the influence of information technology by which cultural, economic and social changes occur. Thus, it can be seen as the most important contemporary economic process: it arguably enforces countries and companies to adapt to the new ICT paradigm (Schienstock 2007). This process pressures countries towards liberalization, internationalizes science and technology and increases competition (Freeman 2003, 48). Hence, on the one hand, globalization is seen as synonymous to economic integration and the decline of the impor-

tance of geography (e.g. Benner 2003; Bunnell and Coe 2001), but on the other hand, all actors are not affected equally (e.g. Reuveny and Thompson 2007).

Globalization and the ease of transportation and communication have led to a surge of outsourcing to low-cost locations. However, knowledge-intensive activities mostly remain in advanced economies. For a competitive advantage, the existence of a competitive local cluster in terms of productivity and innovation is perceived to be increasingly important (regarding cluster economics, see Porter 2000). Thus, the spatial impact of globalization manifests as a greater variety of possible knowledge linkages and global production networks (GPNs). These networks agglomerate knowledge capital and innovative activity to a small number of highly specialized high-technology spaces in the higher tiers of GPNs and de-agglomerate production in the lower tiers. Therefore, the most prevalent trends of globalization seem to manifest themselves with the expanding openness of economies, the internationalization of technologies and “geographic dispersion” (Ernst 2002) of production. These processes influence the innovation-based growth that is for now the economic measure by which the sustainable growth and success of countries is defined. In the global economy, innovation and innovation-based productivity growth are seen as pre-requisites to economic success (for a review of relevant literature, see Benneworth and Hospers 2007; Temple 1998). Through a greater emphasis on the endogenous nature of innovation (through the great influence of the works of Schumpeter, see, e.g., 1975 [1942]) and a systemic approach to the latter (Lundvall 1992; Edquist 1997; Freeman 1995), economic growth is assumed to be achieved.

The emerging de-agglomeration of industries and the structure of new GPNs create challenges for developed and developing countries alike. Adding to this dichotomy the “size” of states, it becomes undeniably hard to separate “smallness” from other factors and effects of the social world rooted in politics, economics or geography. Therefore, this article will try to define the concept of “smallness” as a (dynamic) marker for states which it directly influences regarding their economic activities (e.g. making economies of scale more difficult to exploit or becoming over-dependent on one or two export products and export markets). Through the threefold influence of globalization – the increasing openness of economies, the internationalization of technology, the emergence of GPNs and the growing influence of multinational corporations (MNCs) –, this article will try to shed some light on the concept of “size” in the 21st century.

2. Context-specific definitions of “smallness”

Until now, “smallness” has been looked at from an international-relations perspective (the small power and the impact a state has on the international system (e.g. Keohane 1969; Rothstein 1968)), or it is defined by primary indicators such as population size (e.g. Hein 1985; Kuznets 1960), geographic area/territory (e.g. Jalan 1982), gross domestic product (GDP) or in terms of trade (portrayed in Read 2001). Combinations of two or more measurements have also been used (Downes 1988; Taylor 1969). Still, power-relations tell us more about the international arena and not much about the everyday challenges smaller states face internally. Furthermore, some relatively small states (e.g. Israel) can have a considerable influence on international politics. On the

other hand, GDP does not say much about the state's economic power, development level or the "quality" of economic activity in general. There are highly successful small(er) states (such as the Scandinavian economies, esp. Finland) apparently coping very well with globalization. However, other measurements are lacking in that regard as well (for a compact critique of measurement problems, see Thorhallsson 2006).

Using population as a marker (and it is the most popular characteristic) does not really render a definite result: small states have been defined from 1 million (Hein 1985) to 20 million (UNIDO 1979) and over, with different cut-points in between. The Commonwealth Secretariat (1997) for one has now defined that a country of 1.5 million people or below is small. Others have found characteristics and common problems of "smallness" in much larger states (e.g. Kuznets 1960; Collier and Dollar 1999; Armstrong 2003).¹ In fact, all definitions based on some empirical measure or combination of the latter have a strong arbitrary element to them. For instance, the World Bank defines small states very narrowly with populations under 1.5 million.² This is a clearly arbitrary delineation: in the case of the Baltic countries, this would mean that Latvia and Lithuania are not small states, while Estonia is. Yet, looking at the socio-economic and administrative challenges these three countries face, the similarities are impossible to overlook.³

Indeed, one can speculate that the special interest of the respective academic field itself – international relations, economics or public administration – has defined the "size" of smallness. This ongoing debate does little to clarify small-states theory and Thorhallsson and Wivel (2006) argue that even if an absolute or any relative criterion is used to define "smallness", it will always be subjective and arbitrary. Hence, in the context of globalization, it would be misleading to use objective measures (population, territory, etc.) as cut-points between small and large – if anything, they should be interpreted more as a "continuum" (e.g. Rampersad 2000). Nonetheless, the question remains: what does the continuum consist of?

As stated before, to survive in the global economy, innovation-based productivity is key. Therefore, the viability of states hinges on the ability to counteract or even benefit from the globalizing forces. Looking at the common characteristics and problems of "small" states (thus far identified in the small-states literature (cf. Randma-Liiv 2002; Benedict 1966; Handel 1981; Katzenstein 1985; Kuznets 1960; Walsh 1988)) from the perspective of globalizing trends, we can find the defining features that make countries "small" in this new socio-economic paradigm. In this line, the ability to cope with globalization (through the relative power in the arena of international relations, economics or even the capabilities from public administration) would deem it questionable to mark a state "small" as the size itself is defined by comparison and the most influential force in the 21st century is indeed globalization.

¹ Furthermore, Handel (1981) correctly points out that the criteria of territory or population alone can be misleading as geographically small states can have large populations (e.g. Singapore), and large geographical states can have small populations. Thus, the line between "micro state", "small state" and "middle power" is blurred (cf. Neumann and Gstöhl 2004, 6).

² See, e.g., World Bank. 2000 and Briguglio et. al.2006. While the former focuses on the problems of the Caribbean, the latter is much wider in scope.

³ For a detailed discussion, see, e.g., Raadschelders, 1992 and Crowards, 2002.

3. “Size” and the challenges of globalization

Globalization redefines national borders and their roles in specific factors, followed by negative and positive impact (see e.g. Freeman 2003). Henrikson (2001) finds that decolonization, the end of bipolarity, democratization, trade liberalization and the digital revolution have given all states more freedom. However, increasing openness tends to make countries more vulnerable, exposing them to intensifying competition and fluctuations of global markets. Indeed, there is a tendency towards “internationalization of problems” (Axtmann 2004, 269), because key factors and processes that control policy outcomes are located either regionally or internationally. Based on Katzenstein’s (1985, 2003) research, which argued for the “flexibility” of smaller states, one might conclude that they are actually particularly well-prepared for a world of deregulated financial and increased trade flows. On the other hand, one could argue that states with limited populations (and thus human resources) are but pawns in a game they cannot control or even manipulate (see, e.g., Briguglio 1995; Menz 1999). Where trade and finance are concerned, the size of states has a strong tendency to determine the yield to global politics and vulnerabilities rather than opportunities (Payne 2004). But the lack of control of financial flows between countries is not specifically a “small states” problem.

Previously, many economists (cf. Vogel 1979 through Neumann and Gstöhl 2004; Handel 1981; Lucas 1988) maintained that the size of a state determined its wealth due to the small domestic markets (higher costs of production and lower economies of scale and lack of competition) with the dependency on external trade and recurring trade deficits. Limited resources and smaller home markets have been found to increase export-dependence and lead to more pronounced dependence on foreign capital or no power over fluctuations of the international market (see, e.g., Andersen and Lundvall 1988; Baker 1992). These limitations might as well carry on to a low diversification of economies (and low R&D expenditure).

Certainly, sociologically the most prevalent characteristic of limited human resources/population is the overlapping roles of individuals (a prevalent theme from early works on small states and societies, see, e.g., Benedict 1966⁴). It might enhance learning but it personalizes jobs and limits career opportunities for others, which can lead to the best “brains” fleeing the country (Farrugia 1993). However, Browning (2006) argues that more than ever, “size” is now, in the era of globalization, a perceptual marker (see also Lamoreaux and Galbreath 2008) of being smart and innovative, because in the current post-Cold-War world, the framework of big-small is increasingly less relevant. However, it cannot be assumed that the mechanisms (e.g. R&D effort and spillovers (see Kiander et al 2002)) are the same in all states, differing in population, available resources and even industrial structures.

Thus, through the most prevalent economic trends that are emerging because of globalization – expanding openness of economies, internationalization of technology

⁴ Benedict is often credited with differentiating between small states and small societies: the main criteria of size for “territories” (“states”) are area and population, whereas the criteria of size for “societies” are the number and quality of role-relationships.

and the geographic dispersion of economic activity –, the determinants of the “size” of states are changing. The new socio-economic paradigm, the ICT paradigm (see Perez 2002), is shifting the bearings of the entire social and economical world, and this includes the concept of size. Global competition has increased, and the world has opened, the economy itself is going through a transformation to which the coping mechanisms are different, varying the characteristics determining the economic size of states. This process can marginalize some “objective” characteristics of “size” and introduce others to the table. Using the three prevailing trends of globalization mentioned before, this article will continue to explore the “size” and especially the “smallness” of states in this new paradigm.

3.1 Expanding openness of economies

Globalization has promoted the “structural openness” of economies (Ebner 2004), and although all states are open to a degree, the extent of openness varies. The “hollowing out” thesis (Ettlinger 1999, 339) holds that supranational institutions have eclipsed the nation-state as the locus of power. Indeed, an emphasis on “Washington Consensus” (Williamson 2002) style policies (low inflation, balanced public budgets, etc.) have led governments to pull back from playing an active role in the economy. On the one hand, the importance of an industrial policy has diminished, and on the other, an over-emphasis on innovation policies targeting mainly high-tech sectors has emerged (Lundvall et al. 2002). These policies tend to de-agglomerate economies even further and make countries more dependent on outside forces. The last three decades made developing countries, and particularly those more integrated into world financial markets, swing at the rhythm of highly pro-cyclical external financing (Griffith-Jones and Ocampo 2007). As a result, poorer nations seem to be characterized by the effect of being locked into a “vicious circle” (Reinert 2006, 8) with reverse flows of capital following periods of financial crises from developing to developed countries. The current crisis and its strong ripples around the world show how fragile this openness is.⁵

Deregulated markets and a more laissez-faire role of the state (Casey 2004) are believed to generate a climate of heightened risk, uncertainty, contingency and considerably reduced bargaining power of states (Coe et al. 2008). High-level structural openness (a high share of trade in GDP) requires the pursuit of export-led growth policies (see Armstrong and Read 2006; Moses 2000), which is a double-edged sword, because export preference requires integration into the liberal policy realm. Extreme openness combined with limited home markets (and their stage of complex-

⁵ Financial instability is a long-term growth path of laissez-faire capitalism: finance flows are always subject to what economist Hyman Minsky (1919-1996) calls a “Ponzi” investment profile (magnifying the (almost) natural “urge to speculate” (Minsky through Padiaditakis and Thomaidis 2006, 2) in companies that need to increase their borrowing speculatively just to stay in business, but to which, according to good credit assessment, bankers should not lend under any circumstances) that exhibits extreme financial fragility irrespective of whether the funds are used for productive or wasteful purposes and irrespective of the robustness of the financial system and the attractiveness of the domestic environment (see further Burlamaqui and Kregel 2006).

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ity) means that states are in danger of becoming “price-takers” in export markets and having very little influence over their terms of trade. Modest political and economic resources of states leave them generally unable to exercise significant control over the condition or regulation of these markets (see, e.g., McCann 2001). The high level of concentration in domestic economic activity and trade, coupled with the high exposure to exogenous global shocks, means that their growth can be expected to be of greater volatility.

Within the emerging global economy and the GPNs, MNCs’ actions can add up to a collective force that serves as a “mediating middle” (Chen 2008) between the global economy and local economies within apparently “glocal” spaces (Benneworth 2006, 23). However, businesses generally find it easier to outsource perfection-related or cost-reduction-related innovation and perform most of their R&D at home (Kumaramangalam 2003; Jakobsen and Onsager 2005). The result might in fact be a “race to the bottom” (Cox 2008; Nayyarm 2006) with other similar countries, while more advanced countries might fall prey to anxieties about cross-regional disparities in knowledge-based wealth creation within particular nations and about the offshoring of knowledge-based tasks and jobs (Huggins et al. 2007). For developing countries’ assets in general tend not to complement MNCs’ high-tech assets (Asheim and Vang 2006, 45-46). A swarm of developing countries compete for establishing themselves as cost-attractive areas, without having more to offer than cheap labour, low taxes, poor environmental regulation and “flexible” labour-market laws. Therefore, the outside forces that push for more structural openness might force (especially developing) states even further into cost-based competition in areas of little or no increasing returns when dynamic relationships between actors within their production systems are lax or non-existent.

Consequently, states have become more vulnerable to the consequences of the rapid inflow and outflow of foreign short-term investments, i.e. capital flight. Nevertheless, states need to attract more “sticky”, technologically oriented FDI (Kiander et al 2002; Sutton and Payne 1993; Tiits 2007), but at the same time, they need secure basic domestic research and education, in order to upgrade absorption capabilities and technological adaptability (Baark and Sharif 2005). It has been argued (Archibugi and Pietrobelli 2003) that governments which are keen to host FDI (as most open states with small markets and export orientation are (see Beers 2003)) should not only negotiate the presence of a technological component. They are encouraged to offer tailored incentives to FDI, but at the same time adopt policies to allow other parts of the economy, outside the influence of foreign businesses and investors, to benefit from the expertise developed. Nevertheless, whereas China, for example, is in the driver’s seat to play off one MNC against another, in negotiations with smaller countries, MNCs are able to play off one country against another to achieve the best deal. Furthermore, the limited size of the relevant labour market and skilled labour will influence the range of industries in which states might successfully specialize (Maskell 2000, 62-63).

3.2 Internationalization of technology

Comparative competitive advantages vary between industries and their markets (Lane 2008), and for long-term growth, a stake in the high-technology and increasing returns is essential. As countries differ in the cumulative process of industrial clustering in spatial contexts, the location effect comes into play and makes industrial performance vary across countries (Chen 2008; Hage and Hollingsworth 2000). Knowledge-based sectors clearly innovate in a different way than the more traditional medium-technology sectors (Tödtling et al 2006; Shapira and Youtie 2008). The growing complexity of new core technologies (e.g. micro-electronics, biotechnology or nanotechnology (Koschatzky 2005)) requires a more continuous flow of science-based input (Meeus et al 2001).⁶ For states with highly limited resources, there is no point in doubling efforts in basic research when the likelihood of achieving market dominance through it is extremely low (e.g. Kiander et al 2002) and when it is unlikely to keep domestically-generated knowledge spillovers to themselves on the global markets. Therefore, a more active role of governments as well as extensive international ties and investment are needed (Amsden 2001). When states have limited resources even to build this infrastructure, they are more influenced by the increasing complexity of technologies and the dispersive effect that ICT has on the global economy. The improvement in technological sophistication and R&D intensity of the more traditional sectors in the larger countries have increased the competitive pressure on other countries in the same sectors, while the newly industrialized countries increase their production in mature technologies (Lall 2004, 4). This puts even developed states with fewer resources between pressures from opposite sides.⁷

Smaller markets do not enable enterprises to recoup high and rising R&D costs (Herbertsson and Zoega 2003), particularly in a time of shortening product life cycles and increased competition. Limited human resources and market can reduce the opportunities to successfully import technologies (Tisdell 1993) or diminish the motivation of private investors to invest in the country, because it is perceived to be too risky or not very profitable. There are limits to the possibilities of states with limited resources in the early stages of technological development because of thresholds in the high-tech industries and R&D and the importance of “forward linkages” (Andersen and Lundvall 1988, 23). Thus, states may lack the critical mass needed in domestic R&D to distribute their innovations more uniformly across technologies (Korres 2007; Maskell 1996).⁸ Consequently, Simai (2003) finds that the way out of this is to make “optimal” use of the internationalization of R&D, which would allow to up-grade the knowledge bases of countries, but only if the “right” policies are implemented.

⁶ The university-industry-government linkages may become even more important in these knowledge-intensive all-purpose-technologies of the future (popularly known as “Triple Helix” models (e.g. Etzkowitz and Leydesdorff 1998).

⁷ Described by Walsh (1988, 48-49) as “small-country squeeze”.

⁸ Particularly in general-purpose technologies as their contribution generally represents only a small fraction of the global R&D invested in developing the same or similar technology (see Kiander et al 2002).

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However, the experience of countries on a lower level of economic development also demonstrates a different pattern concerning the smaller per-capita and total GDP. It influences the amount of funds spent on education or R&D, while the historically accumulated knowledge and capabilities in the society may be even more limited (Simai 2003, 27). These countries must either spread their resources more thinly or select certain areas as priorities for R&D investment. The limited size of the labour market itself increases the penchant towards over-specialization, i.e. “Dutch” disease (locking-in to inferior or aging technological trajectories and resulting low diversification of economy) and employment instability, over-dependence on international technology flows and cooperation (see e.g. Dickson and Hadjimanolis 2001). R&D spillovers in general are difficult to identify and account for, and the nature of the relationship between R&D input and productivity output is one of the least predictable in the scientific and technological economy (Wong and He 2001). Furthermore, according to some (see Sutton 1999), diversity is fundamental, because selective interventions can fail for many reasons, for instance insufficient information, inadequate skills of policy-makers or path-dependency (see, e.g., Breznitz 2006; Parker and Tamaschke 2005; Zhang 2003). Nevertheless, Ketelhöhn (2006, 697) argues that while diversity is indeed more important in determining the “intensity of innovation”, specialization has a stronger role in determining the probability of positive innovation, which might be more important. Furthermore, there are advantages in the economic growth potential from a greater degree of social homogeneity, cohesion and identity, which encourages the formation of social capital and thus lowers many transaction costs (Armstrong and Read 2003; Bräutigam and Woolcock 2001; Hey 2002). Therefore decisions can be reached more quickly; also it is easier to cope with far-reaching structural changes and adjust to new technologies (e.g. Lemola and Ylä-Anttila 2003; Lundvall et al 2002).

High-quality institutions and social innovations thus matter in terms of managing the exposure to global economy, because it can combine openness with dense interaction and internal networking (tendencies that Lemola and Ylä-Anttila (2003) have found in Finland). Indeed, the degree of technological internationalization is more prevalent in countries with low technological intensity (Guellec et al. 2001) (with an incomplete knowledge base and a very weak local base of support industries (Ernst 2002, 500)). This means that states that are involved in higher value-added activities, using human capital more intensively, are more equipped to increase their market size, regardless of the available human resources. This signifies the increasing importance of the developmental level of states and limits the effect of the population variable itself.⁹

⁹ However, highly collaborative societies tend to encourage continuing, incremental innovations, accumulations of organization-specific knowledge (they are likely to emphasize closer-to-the-market R&D (Kiander et al 2002; Walsh 1988)), while adversarial, arm’s-length societies, in contrast, generate greater discontinuities between skills and routines, with more radical restructuring of technological competences (Haake 2002).

3.3 Geographic dispersion

GPNs are no longer formed inside the “lines of national borders” (Tiits et al. 2006, 155) but more as interplay of different communications inside particular industries. Yet, this accumulation process will inevitably assume a geographical shape and calls for states to at least develop adequate administrative capacities and abilities to “sell” and support the technological strengths of their innovation and production systems, which influence the location-choices of businesses that are considering their R&D strategies (Archibugi and Pianta 1992). “Core-periphery” relations are generally neglected when technology is researched (see Jauhiainen and Suorsa 2008), although innovation activities and knowledge flows differ strongly between central, peripheral and old industrial areas (Rodríguez-Pose and Crescenzi 2008). Thus, networking for the sole purpose of innovating is not synonymous with the exchange of “well-structured” knowledge (Maskell 2000, 29), and the success of the former might entail plugging the R&D sites strategically into innovation networks, “cross-cutting different spatial scales” (Phillips and Yeung 2003). While economies are becoming increasingly open, some things find “travelling” more difficult than others. Meske (2002), for one, believes that the international opening-up to high-tech imports and other forms of technology transfer has minimized the need for domestic R&D. Still, the “tacit” components of knowledge (Polanyi 1967) continue to be less mobile and transferable. Furthermore, technology- and industry-specific patterns of innovation are primarily driven by the opportunities associated with each technological paradigm (currently the ICT paradigm).

The economic performance of most states is highly dependent on links with the nearby international “region” (especially when it is close to the “core” of economic activity, e.g. relatively prosperous and high-growth countries (see Beers 2004)). Academic or entrepreneurial collaboration can be notably “thicker” within the same geographic neighbourhood, where similar technological specialization and a “common language” (Guellec et al. 2001) are shared. As the likelihood of academic knowledge spillovers are found to decline substantially with geographical distance (Keller 2002), these technology spillovers are an important asset for foreign high-technology MNCs which make R&D investments in host countries (Beers 2004). However, the absorption capacity and hole composition of the innovation and production system of a state are becoming essential for a balanced, reciprocal relationship and technology transfer with the local industry. Thus, it is not only a problem of economic development and core-periphery relationships, but of the composition of the institutional framework (e.g. the differences of neighbours Denmark and Sweden is well-documented (Benner 2003; Lundmark and Power 2004; Nielsen and Kesting 2003)).

Indeed, research (see, e.g., Yeung 2000) suggests that in the case of relatively “footloose” industrial businesses, strong “institutional thickness” may help to give them a firm footing in specific localities and minimize their willingness to relocate. Export-oriented states with small markets are more “conscious” than large states of the demands of MNCs, as they are typically hosts to only a small number of MNCs (Culpepper 2007). At the same time, the existence of few but large home-MNCs makes it very hard to control the R&D structure. However, states with especially

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limited human resources are characterized by the centralization of their “corporate network”, and a particular “*manière de voir*” (David and Mach 2003) might be highly constructive to economic cooperation,¹⁰ but it can also amplify the danger of lock-in. With clientelist attitudes, “old boy network” pressures and “elitism” of policy-making, it can jeopardize the legitimacy of policies (Kasza 2004). Furthermore, the danger of over-embeddedness in relationships is ever present, and redundant ties can reduce the flow of new or novel information into the network, while the paucity or total lack of links to outsiders who could potentially contribute innovative ideas, can have negative consequences (Hansen and Birkinshaw 2007).

Nevertheless, nurturing initiatives to grow technological, industrial, etc. potential within the innovation and production system of states appears to be the concern of the administrative capacity of especially smaller states that are keen not to find themselves in the inferior/low-wage/outsourced parts of the value chains within the globalized geographic dispersion. Thus, it could be argued that when resources are sparse, there is no other choice than to specialize in a few technological fields and accept the inherent risk that goes with specialization.¹¹ If the capacity to facilitate such change is not systematic or non-existent, serious structural problems may arise in states with varied levels of development, as a distinct difference in the technological level and competitiveness might develop between industries which are integrated into the production and supply system of high-technology MNCs and the rest of the economy (see Simai 2003). In sum, it can be argued that increasing openness and integration of the global economy is in fact a dimension for states in which size becomes an important feature for some states: for instance, the inability to create localized technology-intensive production and knowledge clusters can be seen as a feature of size.

¹⁰ Still, the degree of state corporatism that is acceptable in states in Southeast Asia might not be applicable in other forms of relationships between the principles of specialization, division of labour and technical progress which has a spatial expression and relates to different societal conditions (see Ozawa and Phelps 2003; Roberts 2005). Expectations regarding social welfare and equality are historically diverse, fuelling long-term competitiveness, learning and long-term flexibility of the workforce in different contexts (Sicherl and Svetlicic 2006) (e.g. the DISKO study of the Danish national innovation system (referred to by Lundvall et al 2002)). An active labour-market policy should be thoroughly integrated into the policy response of small states (for support in the workplace and the willingness of workers to contribute to change instead of blocking it (Kuznets 1960; Katzenstein 1985)), which is supposed to be one of the key lessons to be learned from the success stories of East Asia (Mehmet 2003). The state encouraged MNCs to establish manufacturing facilities in Taiwan, but unlike Ireland, Taiwan then pushed these companies to procure an increasing number of components locally and to transfer the necessary skills and know-how for their production to local suppliers (Breznitz 2006). However, in the era of globalizing processes, it is a major challenge to try to make culturally and ethnically cohesive states open so that they can allow for the co-existence of cultures and ethnicities without undermining the social capital that keeps them together (Lundvall and Tomlinson 2000).

¹¹ Embedding strong clusters in an otherwise fairly diverse local economy is preferred, otherwise opening the borders to foreign MNCs generally allows them to dominate the domestic technological scene through inward foreign direct investment (FDI) and takeovers of domestic businesses (see the Flemish dilemma in Capron 2006).

4. What is small in an area of globalization?

Scale is indeed a “fluid and multidimensional concept” (Bunnell and Coe 2001, 570), delineating the complex interactions between physical space, institutional and regulatory jurisdictions and the shifting levels of economic actors. The “size” factor thus far has had important implications for economic performance, and most concerns have been concentrated on the implications of small population size and negligible local markets. Still, the challenges countries face are not exclusive to small size in absolute terms. The discursive structures of “big-small” or “core-periphery” alone do not put innovation and smartness into the dichotomy of size. If we take the latter into account, the driving forces of globalization identified in this article are not insurmountable. In fact, the economic performance of many states, but by no means all, that are thus far characterized as “small”, has been strong, whether in terms of their growth rates or income levels (see further Mehmet 2003).

Previous argumentation has led to the conclusion that in the 21st century, “smallness” is not defined by absolute variables, but processes such as increasing openness, internationalization of technology and geographic dispersion have created opportunities and changed the economical and, to a degree, social world in which traditional state variables (see further in paragraph 2 of this article) such as territory, population, total GDP, etc., are not ultimate and defining characters of countries and their size. Today the open capital markets influence all countries both small and large, while indeed the policy responses differ.

Thus, this article shares the optimism of Yeo (2004) who maintains that if (small) countries can learn to deal with the vagaries of large capital flows and a heavy dependence on external trade, they can reap the benefits of globalization. Nevertheless, “learning to deal” successfully with globalization would signify very high levels of policy and administrative capacity, policy leverage and selection (state capacity). Some states with limited populations and/or territories manage to generate a relatively high GDP per capita when compared to other developing countries, in spite of their high exposure to external economic shocks (a phenomenon aptly termed the “Singapore Paradox” (Briguglio et al. 2005)). Furthermore, Bräutigam and Woolcock (2001) found that while relatively small countries are clearly more vulnerable to rapid fluctuations in the fortunes of the global economy, there are no significant differences between small and large countries in terms of the quality of their institutions. However, high-quality institutions in states with fewer resources matter more in terms of managing already high levels of globalization. Stronger state capacity is more likely to produce higher economic growth rates.

States might not be passive victims or neutral arbiters of globalization processes, but the policy tools at their disposal dictate the actions available to them. The policy options at hand for states to host foreign R&D-intensive MNCs are determined by the position that the countries are able to take in a GPN (Ernst and Linsu 2002; McCann 2001). This and the combination of geographic location (most commonly – “remoteness”) and economic specialization patterns (Kattel 2008, 16-17), i.e. the position in a GPN, is what determines the pattern of development and growth, becomes the determinant of “size”. Development and remoteness (geography) considerably magnify the divergence between states, as developing countries are even

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more disposed to liberal macro-economic policies and, being unequal partners, they have to bear the most unfavourable consequences with very little administrative capacity to promptly react to them.

For instance, the three Baltic States have a high degree of intraregional trade patterns, although no significant cooperation on R&D, while other countries, for instance Finland and Sweden, have much more universally internationalized trade relations in the ICT area (Falch et al. 2006). The intensity of these different merging points of regional cooperation depends upon the capacity to contribute to the principles of reciprocity and solidarity (Molina-Morales et al. 2002). Having few possibilities of doing so makes countries “small” in the global economy. However, participation of what can now be described as “small” states in regional groupings is arguably a strategy to secure a better trade-off between economic advantage and the protection of sovereign authority and power than is available through participation in global multilateral arrangements (McCann 2001, 293-295). Because especially developing countries have to grapple with unstable exchange rates (and raids of speculation against it), extensive short-term debt by their private sectors, deteriorating terms of trade and rise of protectionism in industrialized countries (see Rampersad 2000), the standard population marker does not hold true. Thus, the development level contributes to the “smallness” of states, and countries with much larger populations could also be considered small.

Population size and available resources can and do influence the inner workings of the economies of different states, but the ability to find niches and context-specific solutions within the changing global economy is not totally out of reach. Therefore, “size” in the traditional sense becomes a constraint only when the effects of these absolute measures lie far outside the control of the state and the institutional infrastructure. This makes it impossible to react to the forces of globalization that influence most countries and in effect make economies “smaller” than the absolute measures lead us to believe. The opposite holds true as well: on account of high developmental levels, administrative capacity or strategically better geographic locations, traditionally “small” countries have more options to react to new paradigms and absorb new technologies, thus growing in economic size (e.g. the Scandinavian countries or the Asian Tigers) (see Figure 1.). If they do so or not is outside of this argument, because even undoubtedly great nations have lost competitive advantages.

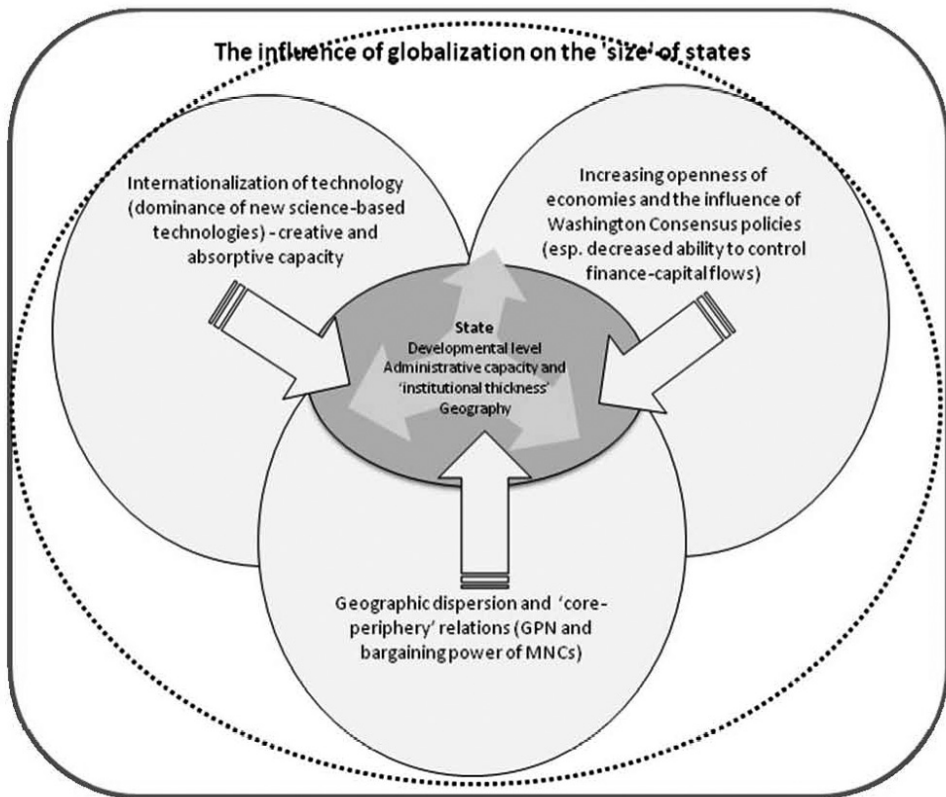


Figure 1: The influence of globalization on the 'size' of states

5. Conclusions

This article reaches the conclusion that “smallness” has important implications on the economic performance of states. On the whole, these effects intensify with the influence of geography (core-periphery relationships), the developmental level and the technological and industrial specialization of states. “Size” interplays significantly with the developmental level, economic specialization and closeness to dynamic markets and forefront research. The influence of the latter can help or hinder, enlarge or diminish the positive and negative effects to the nation-state perspective in the new ICT paradigm. Consequently, the capacity to enhance or delimit the effects of globalization and respond to the new forms of economic systematization brought on by new technologies is the key to divide between small and large countries. Therefore, the policy responses to globalization (effects and policy options broadly referred to in paragraph 3) – led today by the ICT paradigm – are available for those states that can capture the “heart” of the paradigm. Thus, through the effects of globalization, the concept of “size” becomes more dependent on the state capacity to administer change and cope with deficiencies (and all countries have them, but the policy-toolkit available for them is different).

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The developmental level, administrative capacity (i.e. available policy options and capacity to administer them) and geographic location (closeness to the “core markets”) have a more direct influence on the qualitative “size” of the economy than the numeral of the population or territory of the state alone. The ability to focus available capabilities, absorb technologies from abroad and react to change is more essential in the ICT paradigm for innovation-led productivity growth from the perspective of the state. Globalization delineates the definition of a “small state” from objective markers of size to a growing focus on “smartness” or “innovation” and the aspect that influence the latter, thus determining the real “size” of states. The synthesis of works presented above shows that the composition of the economy, developmental level (and thus the capacity to manage change) and specific characteristics, e.g. the geographical situation, play a decisive role at least in the economic size and development of states in the 21st century.

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