Assessing the Structure of Small Welfare States

Geoff Bertram

4 Social Policies in Small States Series

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Foreword

During the 1960s and 1970s, increased interest was shown by some international organisations, such as the United Nations and the Commonwealth Secretariat, in small states, notably small island states, and the development challenges they faced during the decolonisation period. With over a third of Commonwealth countries classified as small economies, the Secretariat is committed to the study of small states. The issue of their vulnerability, for example, was first given formal expression within the Commonwealth at the 1977 Commonwealth Finance Ministers Meeting in Barbados. Having noted the special characteristics of small states, in particular their reliance on trade, high dependence on capital inflows and, in some cases, their lack of natural resources, ministers urged the international community to adopt a more flexible approach to their requirements, as well as special measures to assist them. In response, the Secretariat designed a programme to assist in overcoming 'the disadvantages of small size, isolation and scarce resources which severely limit the capacity of such countries to achieve their development objectives or to pursue their national interests in a wider international context'.

In 1983, with the political repercussions of the US invasion of Grenada still resonating, Commonwealth leaders meeting in New Delhi expressed their belief that the problems of small states 'deserved consideration on a wider basis, including that of national security'. A Commonwealth consultative group was therefore commissioned to carry out such an examination. Its report, *Vulnerability: Small States in the Global Society*, published in 1985, was the first to highlight the inherent vulnerability of small states to external interference. In reasserting the vulnerability of and threats to small states, and in outlining economic and foreign policy measures to mitigate these, the report was important in raising their political profile in international forums.

Following this publication, the Ministerial Group on Small States was formed to continue the discussion of issues of importance to small states. At their second meeting in 1995, ministers recognised that the international context faced by small states had changed dramatically since the end of the Cold War. This led to the creation of a Commonwealth advisory group of eminent persons, whose report, *A Future for Small States: Overcoming Vulnerability*, was published in 1997.

In 1998 the Commonwealth Secretariat/World Bank Joint Task Force on Small States was formed. In 2000 the Task Force published its seminal report, *Small States: Meeting Challenges in the Global Economy*. The report concluded that addressing the challenges facing small states requires correct domestic policy, regional co-operation, assistance from multilateral and bilateral development institutions, and improvements in the external environment. It highlighted four areas of special relevance to successful development in small states: tackling volatility, vulnerability and natural disasters; transitioning to the changing global trade regime; strengthening capacity; and benefiting from the opportunities and coping with the challenges of globalisation. It recommended that an annual small states forum, where international donors could report on their activities in small states, be held in the wings of the IMF–World Bank meeting. Small states have garnered additional support and attention from international donors as a result, but more remains to be done: a 2005/2006 review of the task force report established that small states are still vulnerable and continue to face a number of development challenges associated with their size.

In adopting Agenda 21, one of the key outcomes of the United Nations Conference on Environment and Development (more commonly known as the Rio Earth Summit) in 1992, the wider international community also recognised the special challenges that small island developing states (SIDS) face in planning for sustainable development. As a result, the Global Conference on the Sustainable Development of Small Island Developing States took place in Barbados in 1994. The plan that emerged, the Barbados Programme of Action (BPOA), is the principal international framework for addressing the special challenges and constraints faced by SIDS in their pursuit of sustainable development. The BPOA addresses 14 major themes, ranging from climate change through coastal and marine resources to tourism and human resources development.

The ten-year comprehensive review of the BPOA led to the adoption in January 2005 of the Mauritius Strategy for the Further Implementation of the Barbados Programme of Action for the Sustainable Development of SIDS, which includes 19 thematic areas, including climate change and sea level rise; natural and environmental disasters; and energy resources. The Mauritius Strategy notes that for its successful implementation, SIDS require effective human, institutional and technical capacity development; effective monitoring and co-ordination, including through SIDS regional organisations; and support from the international community, particularly through financial and technical backing.

Finally, Millennium Development Goal 8 (on developing a global partnership for development) specifically mentions the special needs of landlocked countries and small island developing states. Yet despite this attention to small states, there are still major gaps in our understanding of their unique development process and experience. Insufficient study has been devoted to the social and economic issues they face. In particular, there is virtually no comparative research on social policy issues or on how social policies affect economic development. This paper, together with others in this series, attempts to fill this gap by taking a distinctive approach to social policy, which it sees as encompassing concerns about redistribution, production, reproduction and protection. The papers show how some small states have succeeded in improving their social indicators through appropriate social policies, how others are moving in the right direction and how some are falling behind or failing. We see that, despite their inherent vulnerability, some small states have been successful precisely because of the complementary social and economic policies and strategies they have implemented. By looking at these countries in comparative perspective, we can draw interesting lessons on policy.

The papers in this series are outputs of the research project, Social Policies in Small States, led by the United Nations Research Institute for Social Development (UNRISD) in collaboration with the Commonwealth Secretariat, from 2007 to 2009. Fourteen country studies were commissioned and their findings were discussed at regional workshops in the Caribbean and Pacific. Four thematic papers framed and complemented the country level research. We hope that the findings of this research will be useful to scholars and policy-makers concerned with the social and economic development issues facing small states.

The research project was designed and co-ordinated by Naren Prasad, with assistance from Nicola Hypher at UNRISD, in collaboration with Constance Vigilance at the Secretariat.

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1

Introduction

This paper, on the welfare state, is a thematic paper for the project on social policies in small states, and is intended to sit alongside case studies on the delivery of social policy in these countries. Its purpose is to show how the characteristics of small states influence the pursuit of a welfare state by these countries. One of the most influential characteristics of small states is openness, where many citizens often migrate or receive remittances as a part of the overall welfare equation. Such countries are often recipients of overseas aid.

Vital dimensions of social policy in small states are concerned with mediating linkages and relationships between the home-resident population (and its government), on the one hand, and the outside world, on the other. These external linkages include:

- **Fiscal funding:** the ability of many small states' governments to provide services, employment and social transfers rests upon a transnational tax base, including overseas aid donors.

- **Diasporas:** the emigrant diasporas of small states remain effectively part of the client/target base for social policy over long periods of time, and the migration-remittance process is sometimes more important for economic development than the more familiar issue of domestic savings and investment. So long as diaspora members retain their citizenship and the right of return, they are effectively part of the set of individuals and groups to whom social policy applies. Social policy is here understood as policy that shapes the long-term structure and functioning of all social groups for which the small state is their economic, cultural and political 'home' and source of identity.

- **Outside influences on the style and substance of social policy:** social policy in small states is driven to a considerable extent by external expectations, demands and pressures, such as conditionalities from international agencies. However, the traditional welfare state literature on small states is apt to overlook this issue by simply assuming that social policy is driven by internal forces and coalitions.

Much of the literature on small welfare states deals with countries whose populations exceed the 1.5 million threshold criterion for small states proposed by the Commonwealth Secretariat. Many of the small states discussed in this paper have not previously featured in mainstream thinking about the relationship between country size and the extent of the welfare state.

A 'welfare state regime' will here be identified as government policies and expenditures aimed to secure to individuals or groups within the client community measurable benefits – some material and some intangible – which those individuals or groups could not secure directly through participation in the market economy. Relevant functions of the state which can be categorised under this heading are the payment in cash of income transfers (often including part at least of the public sector payroll) and the provision in kind of key basic services, such as health, education and housing.

We ask at the outset: how is the 'welfare state' concept to be located relative to the general perception that small states have, by virtue of their size, a distinctive propensity to operate in a socially cohesive, consensual, responsive fashion? The use of the term 'welfare state' carries the implication of formal institutions of government delivering social outcomes 'top-down', and a public sector which is clearly separate from the realm of the private sector. This paper, accordingly, focuses on formal institutions that carry out functions delegated to them by the social collective. This will require some discussion of the extent to which state policy exhibits autonomy relative to the operation of informal social and cultural networks, as well as of the extent to which local political movements and coalitions actually enjoy policy autonomy in a globalised economy.

Casual observation suggests that the formal public sector performs a wide diversity of roles in small states. Some small states rely heavily upon government as the primary source of income and economic dynamism. Take, for example, Connell's (1992) account of Woleai Atoll in the Federated States of Micronesia, where two-thirds of households had members employed in government, and the government wage and salary bill was ten times the size of the revenue from the largest export product, copra. Here the public sector payroll was a *de facto* vehicle for income transfer payments, acting as intermediary in a much larger transnational 'welfare state' arrangement under which external donors (mainly US taxpayers) sustained living standards in Micronesia by government-to-government grants which had the character of social welfare transfers. To describe the Woleai public sector as a welfare state in its own right would be to misconstrue its character, since the dynamics driving and funding its distributional activities were exogenous, not driven by any local democratic project of social construction.

In order to identify and delineate a research agenda on the character and role of the welfare state in small states, this paper starts with conceptual issues, then considers some key hypotheses derived from or thrown up by a review of the literature. It goes on to outline a possible future programme of historical and empirical work on small states' experiences.

The conceptual issues are:

- What are the main working definitions of a welfare state?
- Where did the welfare state come from historically and to which particular historical problems was it a response?

- What sorts of states are not welfare states?

Key hypotheses from the literature are that:

1. The welfare state is a genus within which are found several species (Esping-Andersen, 1990; 1996), which implies that we should be alert for new specimens with distinctive characteristics;
2. The importance of the welfare state varies with population size: it is argued that small states have larger public sectors with a more 'defensive' (protective of groups disadvantaged by the market) social policy role (Cameron, 1978; Katzenstein, 1985);
3. Small societies show greater solidarity and are more resourceful in their ability to solve social problems from below, rather than from above (Richards, 1982);
4. The sort of institutions which are essential for successful development have far more of an activist state flavour than the familiar Washington consensus package (Khan, 2007);
5. The institutions that are observed today in small states are heavily conditioned by historical path dependence, and in particular by the colonial experience (Feyrer and Sacerdote, 2010; Acemoglu *et al.*, 2007).

The discussion in this paper will heavily qualify the second of these points, strongly support the last, generally favour the fourth, and suggest that the third, if true, points to a need to escape from the rhetorical trap of 'welfare state' terminology. In turn, this points to a need for more taxonomic research along the lines of the first hypothesis.

2

Defining and Characterising the Welfare State

The welfare state emerged historically as a top-down solution to the problem of how to secure social protection and security in the context of an urbanised capitalist economy, with large numbers of wage labourers subjected to the depersonalising forces of a commodified labour market, and faced with serious hardship if paid employment was lost for reasons outside the worker's control (for example, injury, sickness, firm closures or layoffs in a recession).

The move from reliance on the rural economy (where subsistence could generally be secured) to wage labour produced increased insecurity. Alongside this were the issues of providing means of survival for the old (since retiring workers leaving the labour force moved into economically idle status in the cities, often without support from extended kin networks) and for the dependents of workers. A key element in this was public provision of health and education.

Barr (1987: 5) concedes that:

> The concept of the welfare state … defies precise definition. … First, the state is not the only source of welfare. Most people find support through the labour market for most of their lives. … Individuals can secure their own well-being through private insurance; and private charities, family and friends also provide welfare. Second it does not follow that if a service is financed by the state it must necessarily be publicly produced. … Welfare is thus a mosaic, with diversity both in its source and in the manner of its delivery. … [T]he term 'welfare state' can … be thought of 'as a shorthand for the state's role in education, health, housing, poor relief, social insurance and other social services' [citing Ginsburg].

Central to the definition is the determination of some limit on what makes a state a welfare state, as distinct from other sorts of states. Proponents of the minimalist state in Enlightenment thinking, exemplified by Adam Smith's classic statement, sought to limit the state to three legitimate roles: defence, justice and public works (Smith, 1776, Book IV, Chapter IX, para. 51):

> All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society. According to the system of natural liberty, the sovereign has only three duties to attend to; three duties

of great importance, indeed, but plain and intelligible to common understandings: first, the duty of protecting the society from violence and invasion of other independent societies; secondly, the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society.

The key qualification in this passage from Smith comes right at the start: 'all systems either of preference or of restraint being completely taken away'. The welfare state emerged from the attempt in European and North American societies (and especially in the United Kingdom) to achieve this removal of 'preference or restraint' in order that the 'system of natural liberty' could flourish. The welfare state was, somewhat ironically, implied philosophically by the Enlightenment at the same time as it was driven into existence historically by the aftermath of the industrial revolution.

To remove all trace of 'preference', income distribution across classes and across individuals must be in accord with some underlying scheme of justice in distribution. To remove all 'restraint', it is necessary to prevent or countervail any exercise of market power which impinges upon the efficient allocation and productive use of resources, as well as to end those government interventions which are designed to benefit particular vested interests at the expense of the nation as a whole. Income redistribution and market regulation become preconditions for Smith's system of natural liberty in any setting where the existing distribution of wealth is unjust or where monopoly imposes allocative inefficiency on markets.

To achieve Smith's preconditions of natural liberty in the historical setting of nineteenth and twentieth century England turned out to require a remarkable expansion of the scope and powers of the state, both to redistribute income in pursuit of social justice, and to regulate monopoly in pursuit of market efficiency as well as social justice.

In addition, Smith's identification of public works as one of the three legitimate areas of state activity opened up an ever-growing category of public goods which are more efficiently provided by the public sector than the private, because of the likelihood of undersupply if such works are left to private initiative, and the opportunity to reap economies of scope and scale by universal public provision.

Smith's case for 'public works' was thus extended, from the nineteenth century onwards, to the direct provision in kind of education, healthcare and sometimes housing for the mass of the population. Direct provision in kind of these basic services was usually considered less fiscally burdensome than paying monetary income supplements to disadvantaged households and relying on them to spend the money wisely.[1]

Consequently, when Barr (1987: 6–7) laid out his 'minimum' statement of what the British welfare state comprised, he included not only social security benefits in money terms (in turn comprised of national insurance and non-contributory benefits), but also 'benefits in kind' – the National Health Service, the education system and public housing. In sum, he estimated expenditure on the 'welfare state' thus defined at £85,722 million, out of total public spending of £163,400 million in 1986/87 – roughly half.

Mkandawire (2006: 1) defines social policy as 'state intervention that directly affects social welfare, social institutions and social relations'. Included among the elements of social policy are 'direct government provision of social welfare through, for example, broad-based education and health services, subsidies and benefits, social security and pensions, labour market interventions, land reform, progressive taxation and other redistributive policies'. Mkandawire notes that the development of social security was inextricably linked with the rise of successful industrial economies in Europe, and he makes a case for universal provision of social security as a key part of the effort to eradicate poverty in developing countries.

The notion that the state has a responsibility for the welfare of its citizens became part of the 1948 UN *Universal Declaration of Human Rights*, which sets out several specific sets of rights that are potentially relevant to this paper: the right to migration (Article 13); to 'social security' and 'dignity and the free development of personality' (Article 22); to a fair wage, equal pay for equal work and the right to organise (Article 23); to 'a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control' (Article 25); to free primary education (Article 26); and to participation in cultural life and possession of intellectual property (Article 27).

Of these, Townsend (2007: vii) emphasises the right to social security and the right to an 'adequate' standard of living. These define the minimal welfare state, forming component I in Figure 2.1 below.

Free primary education and access to advanced education, along with universal healthcare, gives a second component of a possible welfare state, component II.

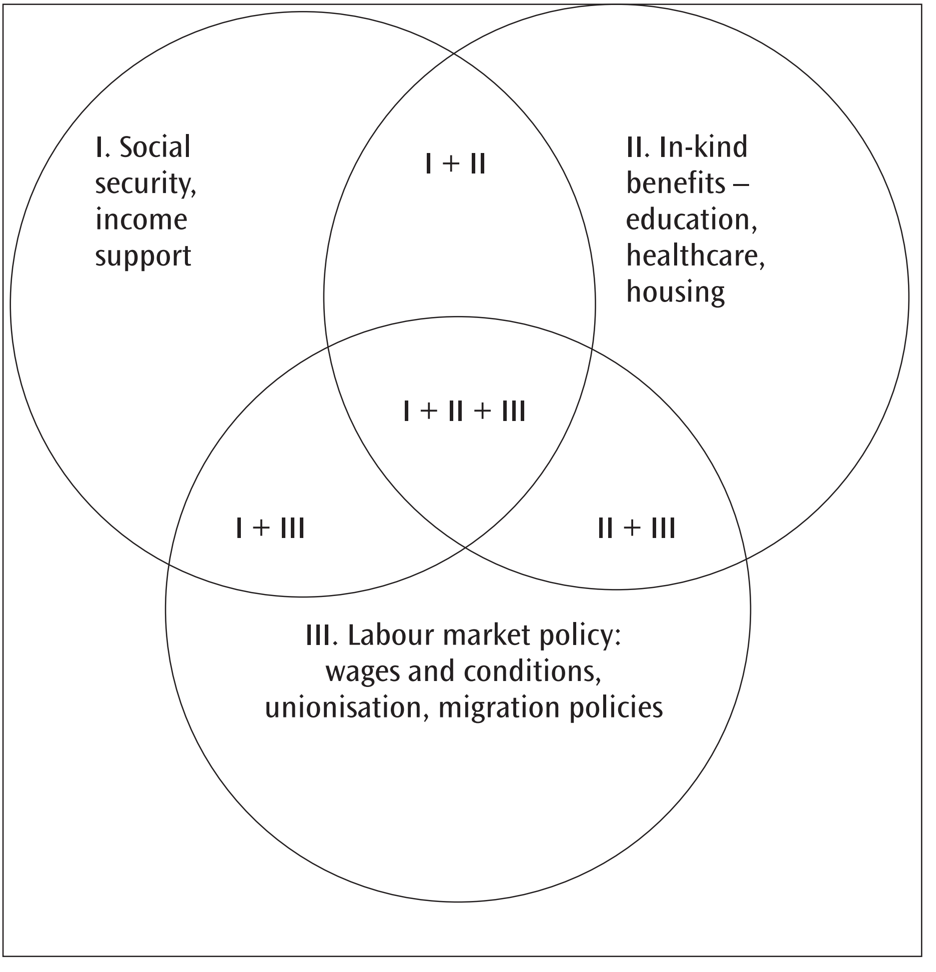
Adding some of the labour market rights, including migration, 'just and favourable conditions of work' and unemployment protection, adds component III.

In a welfare state of type I the state's responsibility is to fund and organise income support for individuals or groups who have been unable to achieve 'adequate' living standards in the marketplace.

In a welfare state of type II the state takes responsibility for underwriting the education (human capital acquisition) and health of new generations entering the labour force and the community – effectively an investment in the future and in widening people's horizons.

Clearly, there is a large zone of overlap, I+II, into which many actual Organisation of Economic Co-operation and Development (OECD) welfare states fall.

Figure 2.1. The welfare state menu



In region III of Figure 2.1 the focus of social policy expands to regulation of workplace practices and responsibility for the life-cycle prospects of the state's citizens wherever they may be in the global system; in the overlapping parts of the diagram I+III, II+III, and I+II+III the social security and education functions become linked to labour market dynamics and outcomes.

Pure type-III welfare states are rare among large economies, but can potentially be found in some small states where living standards and life prospects hinge upon migration and in which public services are undeveloped or routinely accessed overseas. In the small states setting, involvement of social policy with the labour market seems inescapable because of the widespread role of out-migration, both as a positive path of upward mobility and as a safety valve in the face of falling incomes, health, education or other indicators of social welfare at home.

Migration potentially replaces a state-funded safety net as a refuge for the destitute and the unemployed, reducing the residual social welfare clientele of non-migrants for whom remittances are inadequate to meet the government's target living standard for its citizens. This is true whether destitute individuals migrate on their own account or are supported by remittances sent home by migrant relatives.

It should be possible to map small states onto Figure 2.1 in much the same way as they are mapped onto modes of economic development in Bertram (2006) and Baldacchino and Bertram (2009).

3

Classifications of Welfare States

The diversity of possible welfare state combinations in Figure 2.1 renders problematic any unified concept of *the* welfare state. Marshall (1950), writing in an era of strong policy consensus throughout the Western developed countries in favour of a government commitment to underpinning material living standards and providing citizens with access to education and healthcare as of right, saw the welfare state in terms of social citizenship and inclusion – a natural outgrowth of the democracy and rising living standards that were in turn the fruits of industrialisation.

Observing the emergent welfare states of the 1950s, Titmuss (1958) divided them into two generic species: residual and universal. Esping-Andersen (1990) offered a cross-cutting classification into three types of welfare state on the basis of their function in relation to the interests of key power elites and/or social classes. The three types are: conservative (corporatist/Bismarckian), liberal and social-democratic. Esping-Andersen thus emphasised the co-existence of a variety of historically based (path-dependent) models of the welfare state, and threw into doubt the 'modernisation' thesis of institutional convergence driven by the common imperatives of industrialised society.

Esping-Andersen's (1990) approach sits easily alongside the path-dependent model of historically evolving class coalitions developed by Moore (1966) to account for institutional divergence rather than convergence over time, leading to a multiple-equilibrium capitalist world of co-existing alternative types of state. Esping-Andersen's subsequent (1996) comparative study of East Asian, Latin American and Eastern European states, against the benchmark of the apparently crisis-ridden European, North American and antipodean ones, expanded the menu by adding an East Asian 'Confucian' model of 'familialistic welfare' and a 'social investment' model with dynamic growth-oriented objectives rather than the traditionally more static, defensive concept of social security (Esping-Andersen, 1996: 23, 25, 267).

At the broadest level, some writers seem to equate the welfare state simply with a large state sector, whether measured in terms of the tax ratio to gross domestic product (GDP) (Cameron, 1978) or the ratio of state sector employment to the total labour force. But as Esping-Andersen (1990: 19) cautions: '[a] focus on spending may be misleading. Expenditures are epiphenomenal to the theoretical substance of welfare states.' He adds:

> The welfare state cannot be understood just in terms of the rights it grants. We must also take into account how state activities are interlocked with the market's and the family's role in social provision. These are the three main principles that need to be fleshed out prior to any theoretical specification of the welfare state.

The promised theoretical specification, however, failed to materialise in any clear-cut form in that book.

This leaves us with a problem when we come to interpret the tax and spending aggregates in the government finance statistics of small states. Looking back to the passage from Adam Smith above, his three duties of the sovereign defined the minimalist state of neoliberal theorists such as Nozick (1974). Defence of the realm, and a narrow reading of both administration of justice and conduct of public works, yield a state which exists purely to facilitate the individual in the pursuit of his or her own interests and takes no responsibility for the level or distribution of income that results from the outcomes of individual actions. These functions constitute the non-welfare state core of any government budget.

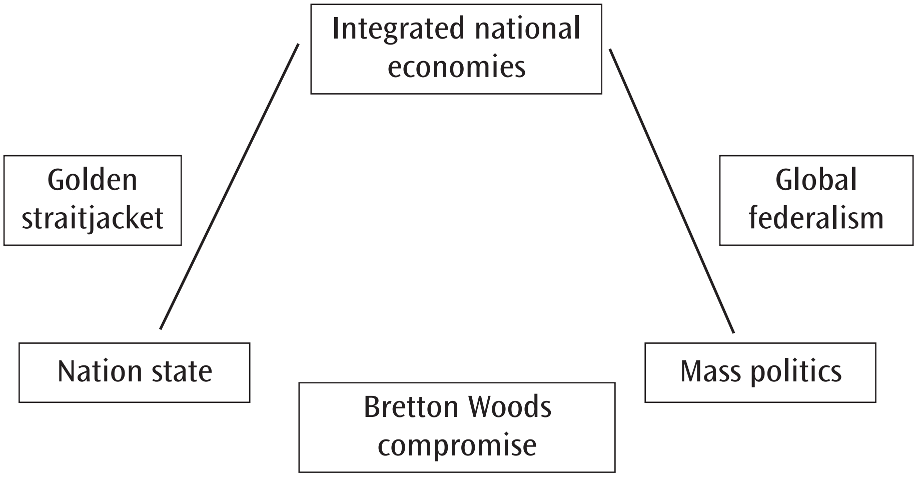
Starting from this core, it is common to assume that adding functions to the state's mandate is the main source of increases in the size of government, so that a large public sector relative to the economy as a whole serves as an indicator of a 'welfare state'.[2] However, a simple ranking of states by the ratio of government revenue or expenditure to GDP will not necessarily identify welfare states at the top and neoliberal states at the bottom of the list. Some disaggregation will be essential, and this will require identification of those government functions which lie outside the 'welfare state' envelope, as well as some qualitative account of what makes a small state a small welfare state.

4

Welfare States and Globalisation

The issue of domestic policy response to globalisation appears in Rodrik's (1997; 2000; 2005) discussion of what he terms the 'political trilemma of the world economy' which, although not cast in terms of small economies, has resonance.

Figure 4.1. Augmented trilemma



The three nodes of the trilemma are international economic integration, the nation state and mass politics. The term 'nation state', as used here, refers to territorial-jurisdictional entities with independent powers of making and administering the law. 'Mass politics' refers to political systems where: (a) the franchise is unrestricted; (b) there is a high degree of political mobilisation; and (c) political institutions are responsive to mobilised groups.

The implied claim of the trilemma is that one can have at most two of these three things. If we want true international integration, we have to go either with the nation state, in which case the domain of national politics will have to be significantly restricted, or else with mass politics, in which case we will have to give up the nation state in favour of global federalism. If we want highly participatory political regimes, we have to choose between the nation state and international economic integration. If we want to keep the nation state, we have to choose between mass politics and international economic integration. …

The essential point is this: once the rules of the game are set by the requirements of the global economy, the ability of mobilised popular groups to access and influence national economic policymaking has to be restricted. … The price of maintaining

> national jurisdictional sovereignty while market become internationalised is that politics have to be exercised over a much narrower domain. Rodrik, 2000: 180

In an earlier work, Rodrik (1997: Appendix 1) argued that in a globalising world the bargaining power of labour in each country would fall, due to the ability of capital to move to locations which offered low wages with high productivity. This increase in the elasticity of demand for labour would reduce not only the ability of workers to organise to improve their conditions, but equally the ability of their national governments to intervene in their favour, since 'footloose' transnational capital can always move its operations to other, competing, jurisdictions. This reasoning drove Rodrik to conclude that the role of the state in a globalised economy becomes defensive and compensatory, refraining from confronting transnational capital in any proactive sense, but acting to top up low wages by increased provision of transfer benefits in cash and kind. An expanding welfare state, in short, is conceived of as a reflection of weakness and dependency in the face of global forces which are beyond the local jurisdiction's power to control, once the fateful choice of openness has been made.

Rodrik has a frame of reference which does not really extend to very small jurisdictions. He is thinking of political units of such a size that the labour force is fixed in place, while capital and goods flow increasingly freely across the borders of the state. As labour conditions are then depressed by the shift of relative power from labour to capital, domestic redistributive policies become inescapable if national government is politically accountable to the local 'losers' from globalisation. From here, the logic of Rodrik's analysis leads him to an argument for global federalism, on the basis that only at global level can the balance between popular forces and capital be made more equal again.

In sum, there are a number of highly influential studies arguing that social corporatism and centrality of welfare state provision (whether conservative, liberal or social-democratic in Esping-Andersen's (1990) typology) are most prominently encountered in smaller states for which globalisation presents the greatest instability and uncertainties, and where a political premium consequently attaches to social security in the face of adverse economic shocks.

However, these writings on small states, which limit their case studies to countries well above the 1 million mark (and generally focus on countries with populations of between 5 million and 10 million), suffer from a lack of engagement with the experience of the large number of small states which lie around or below that threshold.

The traditional welfare state works with disembodied aggregates and is designed to affect large homogeneous aggregates of citizens. As it emerged in its various forms in Europe and North America, it was a formal sector set of institutions and practices applied in the context of broad impersonal forces – industrialisation, proletarianisation, commodification of labour, alienation and anomie.[3] The welfare state provided a substitute for the security that individuals had previously experienced through the informal mechanisms of family, clan and community in pre-industrial society.

Because of economies of scale and scope, industrialisation has historically proceeded most dramatically in economies with populations above a threshold somewhere between 5 and 10 million. At these population sizes, impersonal statistical measures of welfare become relevant[4] and depersonalised policy interventions such as universal benefit entitlements become an efficient policy response. Similarly, as population size increases, economies of scale in the provision of public goods such as health and education become more obvious and it is efficient to install specialised facilities to cater for these needs, with the citizenry enjoying access as of right (with or without payment of user fees).

In contrast, in some small states, poverty and its consequences are expressed individually, and often confronted and resolved at the level of the village community. The need for the state to deal impersonally with large aggregates is reduced, meaning that universal benefits may be less effective than well-targeted individual support measures, while at the same time diseconomies of scale in providing specialised health and education facilities make it uneconomic to sustain a complete portfolio of services locally. For specialised health problems, transporting the patient to a larger country's facilities is the rational course of action, and giving local students scholarships to pursue advanced studies in larger countries makes more sense than trying to sustain world-class educational facilities at home. The increasing international mobility of people reinforces these considerations.

Considerations such as the above suggest that the welfare state as an institutional construct in its traditional form is likely to be less, not more, prominent in very small than in larger polities, because:

- The informal networks and personal support mechanisms for which the formal welfare state is a substitute are both more widespread and more likely to persist in very small states;

- Industrialisation and commodification of labour power tend to be limited in very small economies because of the absence of economies of scope and scale in production and because of the incomplete proletarianisation of the labour force (which encompasses retention of membership in networks of kin, clan, village and community, and the successful reproduction of informal support networks within society to provide the first line of social security protection);

- Public goods provision by the state becomes narrower in scope in very small communities because services requiring highly-specialised facilities (e.g. universities and research institutes) and that are subject to large economies of scope and scale (for example hospitals or specialist surgery) are more 'footloose' (apt to locate in higher-yielding locations in larger countries, with the client base becoming internationally mobile in order to access the services – the service itself, in other words, is outsourced). Note here the funder-provider split issue: insofar as it is the willingness to fund health and education that distinguishes the welfare state, rather than the direct provision of the services in kind, it is problematic to insist that provision of the service must take place within the home territory as a defining part of the definition of a welfare state.

Since it seems that population size correlates positively with some forces that favour the welfare state but negatively with others, it is unlikely that a linear inverse relationship will exist between population size and prevalence of formal state welfarism across the whole size spectrum. The need for social security mechanisms may increase as population size falls, but the endogenous ability of a society to respond to that need by informal bottom-up mechanisms based on family, community and personal relationships rises sharply at some point on the descending size scale, reversing the trend towards greater state provision of welfare and substituting away from such formal mechanisms towards a greater reliance on social networks and personal relationships.

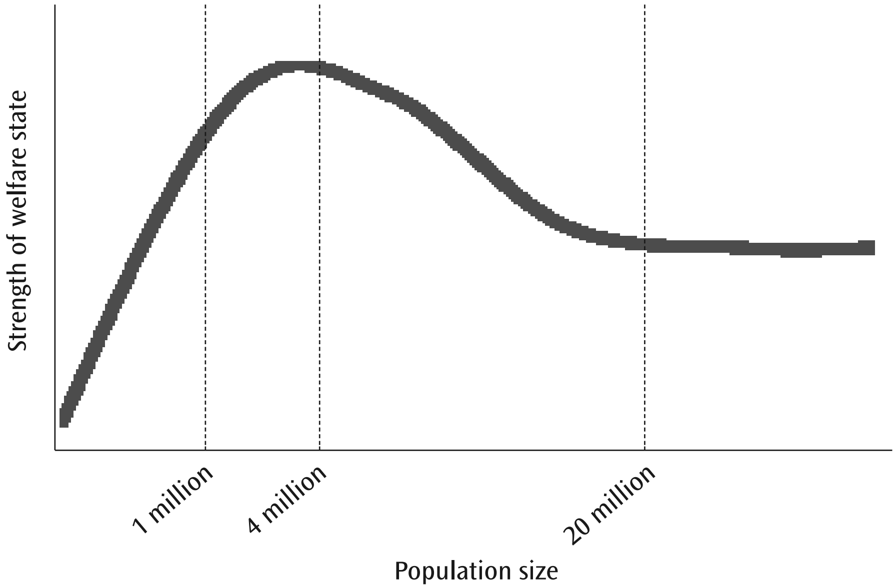
This suggests the relationship between the prominence of welfare state institutions and population size shown in Figure 4.2.

The population thresholds in Figure 4.2 are impressionistic at this stage. Four million is the smallest country in Cameron's (1978) sample from which he derived a linear relationship between 'openness' (the ratio of trade to GDP) and the share of tax revenues in GDP. Katzenstein's (1985) book similarly makes the case for smaller states to exhibit greater social cohesion and welfare state corporatism on the basis of a survey of countries with populations above 3–4 million. Hence in Figure 4.2, over the range from 3–4 million to an arbitrary 20 million, I have drawn the Cameron–Katzenstein relationship, with welfare statism rising as population falls. But to the left of 3–4 million I have hypothesised that this relationship cannot be extrapolated out of the sample into the population size range below 1 million, because in this size bracket the countervailing advantages of informality and non-governmental social networks provide an increasingly efficient and cost-effective substitute for the welfare state.

In the extreme case at the left-hand end (Pitcairn Island with its population of around 50), a welfare state may not be necessary since Pitcairn Islanders routinely travel to Australia, New Zealand or the USA to access most government-provided services, and the means by which budgetary grants from New Zealand and the UK are disbursed to enable island residents to purchase the imported goods and services which underpin living standards on the island are not the formal benefits or social security provisions of the welfare state, but highly personalised payments for services provided.

If the extreme case is accepted as an anchor at the left-hand side of Figure 4.2, it is obvious that the Cameron–Katzenstein relationship must have a maximum at some point – I have put it at around the 3–4 million population mark in the figure. A number of small states around the one million population mark have elements of a partial welfare state about them (Mauritius, Fiji Islands), but they are less clear-cut than countries around the four million mark.

Figure 4.2



Of the eight states in the world that have populations of between 1.8 million and 3.1 million population only two – Slovenia (2 million) and Armenia (3 million) – come close to the levels of industrialisation and economic development generally associated with the welfare state, and neither would qualify as a leader in terms of state welfarism. (Uruguay, a well-established welfare state from the early twentieth century, has 3.5 million; New Zealand and Ireland – both of which have stronger welfare states than Uruguay, though they are similarly exposed to Katzenstein's external instability – have 4.1 million each.)

To study the impact of globalisation on local politics, the small state is an ideal laboratory. At the small state level, countervailing power is exercised against the negative side of globalisation in a variety of ways that depart significantly from the defensive, redistributive welfare state paradigm of authors such as Rodrik. First, labour becomes footloose alongside capital: workers move to high-wage locations as capital moves the other way. In the process, forces are set up which should ultimately, if reproduced on a larger scale, tend to equalise working conditions across countries, not necessarily on terms wholly favourable to capital. This in essence is the outcome which Rodrik had in mind in his advocacy of global federalism, but the mechanism is the market process of migration rather than the political project of constructing a global state.

Second, the domestic tax base in small states is commonly too small to sustain internal policies of redistribution. A self-contained welfare state requires some group in the community with high taxable capacity, from whom revenue can be extracted to pay benefits to the disadvantaged. But the essence of being small is that the entire population shares much the same set of circumstances, driven by external forces. The redistribution that is required to compensate for the negative effects of globalisation is redistribution across countries, from the 'winners' to the 'losers' – not the redistribution within the nation state that is the focus of Rodrik.

Far from being defensive, the successful small state is of necessity pro-active, seeking means of drawing from developed countries transfers to small states. The mechanisms through which this process of implicit international taxation operates are many and varied, but two are of clear salience: 'aid' and trade subsidies. These trade subsidies, which in the past were offered mainly under the European Union (EU)–African, Caribbean, Pacific (ACP) trade agreements have been eroded under the World Trade Organization's (WTO) trade liberalisation agenda.

Smallness becomes overwhelmingly important in this context. When a large country extracts economic surplus from a smaller one, the process is generally perceived, especially by the population of the territory from which surplus is being removed, as a predatory exercise of superior power and force – what used to go by the name of imperialism. When the power relationship is reversed, however, the political dynamics are entirely different. Surplus flows (if and when it does) from the large and powerful to the small and powerless by the consent of the former's governing coalitions. (However, recent data shows that aid to small states has declined.)

Cameron's (1978) sample of 18 countries was limited to OECD member states, of which the smallest was Ireland, and the same limitation of case studies to states with more than three or four million population is found in Esping-Andersen (1990; 1996). In all these states, government is funded primarily by taxes on domestic output and income. There are no major aid-recipient governments and no major royalty-earners in Cameron's sample (his data end at 1975, when Norway was only just embarking on its role as an oil economy). To extend Cameron's regression results out of the sample and down to small states is likely to involve crossing an important qualitative threshold as external revenues rise in importance.

In the data, one relevant relationship to look for is the proportion of total government expenditure that is financed from overseas grants as distinct from revenue from local taxpayers. One hypothesis to examine is whether government payments of transfers in cash and kind to the home population will be greatest in those small states which have the readiest access to overseas grant and/or royalty funding of the fiscal budget, while restrictions on such grant financing (and on other forms of rent transfers) will induce corresponding restrictions on the extent of welfare state-type expenditures. The 'financing question', long familiar in welfare state debates in large countries, moves in the small states setting from a closed economy to an open economy frame of reference.

This is not a new phenomenon: Bertram and Watters (1985) noted a longstanding pattern of 'colonial welfarism' in the Pacific since the 1940s, as colonial powers such as New Zealand and the USA sought to raise living standards in their territories as part of the transition to decolonisation. They developed a model of the 'MIRAB' economy, an acronym which refers to the dominance of an economy by four economic drivers: migration, remittances, aid and bureaucracy. A central finding of Bertram and Watters' research was the 'jaws effect' that opened up in the government finances of New Zealand-related territories from the 1940s, as expenditure on public services and public sector wages and salaries rose far above onshore revenue (see Bertram, 1993). To see whether the jaws effect has appeared elsewhere, and if so, whether it has persisted, requires further empirical work.

5

The Influence of Openness on the Modus Operandi of a Small Welfare State

As already emphasised, the standard conceptual starting point of the welfare state literature is the closed economy of traditional mainstream economics. Capital and labour stand in contradiction to one another in a social setting whose structural architecture is historically derived from preceding historical transformations in the agricultural sector and the structural shift of employment and output from agriculture towards industry. This economic transformation brought with it a transformation of class structure, with the rise of a large class of blue collar workers, in the context of a wage labour market which commodified the individual and their labour power. The welfare state in its various forms was an attempt to ameliorate various consequences of the unfettered operation of capitalist markets, especially factor markets. Esping-Andersen (1996) identifies two contributions of the welfare state in particular:

- Use of transfers to modify the distribution of income via the market, which left some groups and individuals unable to sustain a standard of living appropriate to membership of modern society. This comprises both payment of monetary transfers to individuals who lack sufficient purchasing power, and direct provision in kind of services such as health and education which are often more efficiently supplied by the state than the market;
- The decommodification of labour that becomes possible when individuals can sustain their living standards without recourse to the market, so that participation in the labour market becomes a matter of genuine choice, rather than absolute necessity.

The small states setting exhibits major points of difference from the OECD societies reviewed by Esping-Andersen (1996):

- The political histories of most small states commence from major historical turning points, preceded by long histories of being embedded in colonial empires. The recent emphasis in the economic literature on the importance of path-dependence in explaining the economic and institutional structure and economic performance of contemporary political units (both national and subnational jurisdictions) (Acemoglu *et al.*, 2002, 2007; Bertocchi and Canova, 2002; Engerman and Sokoloff, 1997; Feyrer and Sacerdote, 2010; Hampton and Christensen, 2002; Kapur and Kim, 2006; Moore, 1966; Nunn, 2007) points to colonial experience and the decolonisation moment in each entity's history as fundamental to the present institutional set-up. More recently, the transition experience in Eastern Europe and the former USSR has been the focus of a similar literature for those societies (Blejer and Skreb, 2001; Petrova, 2007).

- Commodification of labour is not as serious a social issue in small states as it is in larger entities, because of the lesser degree of specialisation of labour and the greater residual linkages between urban and rural populations and economies. Until very recently in most cases, and still today in many, both blue collar and white collar wage and salary earners retain(ed) access to family enterprises in the informal and subsistence sectors to which they could retreat in times when alternative employment opportunities were closed to them. The employed worker in small states has generally two alternatives to accepting existing employment conditions: emigrate or return to informal sector activity in the village. As time has gone on and transnationalisation of kin, community and village networks has proceeded, emigration has increasingly become the default strategy of choice, with involution as the final resort. The point here is that the existence of both these exit doors from the waged and salaried workforce makes the issues of wage levels and work conditions less politically stressful in small states. Especially when the migration door is open, local employers face the discipline of metropolitan wage rates as the benchmark for local rates of pay, giving workers greater leverage in bargaining than they could obtain by organised union activity in closed economies of the same size. Insofar as labour organisation in closed economies was intrinsic to the emergence of Esping-Andersen's 'liberal' and 'social democratic' welfare states, one should not expect to find the same political dynamics in small states.

Since there are also large private sector transfer payments entering these economies in the form of remittances and investment income, the state is only one of (at least) two conduits through which international purchasing power is distributed to the home population. A potentially interesting question is whether the state's distributions are structured so as to equalise the final distribution of income and wealth, taking account of remittance incomes received and diaspora assets held by certain groups or families in the home population, or whether a universalistic approach applies to the distribution of the government's transfer income (with remittance and other privately received income added on top).

In Tuvalu in the 1980s, for example, employment in the government sector seems to have been allocated on a universal basis, so that most families had one public sector worker on a wage or salary funded largely from overseas transfers (mainly aid). Families which also had a member overseas working as ship's crew would thereby gain some margin in their income for the period of the seafarer's (limited) term of employment.

It is likely to be worthwhile to assemble government finance statistics to identify:

- The extent to which the total fiscal budget is funded from abroad via grants, royalties and subsidies;
- How aid is transferred into home purchasing power for the population at large – via straightforward transfers, via government purchases from local enterprises, or via direct payment of wages and salaries to individuals employed by the state sector;

- The proportion of government expenditure disbursed as wages and salaries to public sector employees and the relationship of the public payroll to the private sector one;
- The share of particular public services supplied in kind (particularly education and health) in the government budget;
- The size of the public sector relative to the total economy.

A related issue is the elasticity of migration with respect to local incomes and opportunities. A high migration elasticity or propensity means that the level at which social security income support levels (possibly including public sector wage rates) are set will have a significant impact on the number of beneficiaries. When the size of the recipient group is endogenous because of migration, the relevant benchmark for 'adequacy' of home living standards is apt to be not so much an absolute poverty or assets line, but rather the opportunity value of labour on the world labour market – in which case the responsibility of the home government for providing transfer payments sufficient to achieve this living standard locally is diluted by the ability of individuals to secure their living standards rights for themselves by moving.

For citizens of small states, the welfare state often operates at more than one level and in more than one location, since migration access to a metropolitan country (often the former colonial power) usually entails access to that country's welfare state benefits. The welfare state benefits to which Pacific islanders aspire are those available in Australia and New Zealand, and the issue is to get over whatever thresholds there are for entitlement to them.

Large diasporas gain their income from a mix of wage employment, business income and welfare state transfers in the host country, with the balance among these varying by place and time. Remittances provide the financial linkage back to the home community – and fungibility means that remittances that come from social welfare benefits are indistinguishable from those funded out of wage packets.

A research programme on the flows of funds passing through migrant diasporas would clearly be worthwhile, albeit challenging to undertake.

6

Institutional Governance in Welfare States

Economists working on economic development have paid increasing attention to institutional and governance issues in recent years. Two themes in particular from that literature are relevant to the present enquiry:

- The distinction usefully made by Khan (2007) between 'market-enhancing' and 'growth-enhancing' governance arrangements;
- The importance of critical past events in a world of path-dependence, emphasised recently by Acemoglu *et al.* (2007).

Both of these lines of thinking represent departures from the orthodox 'modernisation' model, which associated institutional quality positively with level and growth of income per capita, and asserted a causal link back the other way from institutions to growth.

Khan suggests that the 'new Washington consensus' (as described by Kremer, (2004: 222) has used the wrong set of explanatory variables in its regressions linking institutions and growth, and that the appropriate variables would be ones that measured the extent to which institutional arrangements are supportive of rapid learning, technological innovation and political stability in the face of rapid externally-driven change.

Khan describes the central preoccupations of international agencies such as the World Bank and International Monetary Fund (IMF) in their promotion of institutional reform since the 1980s as the quest for 'market-enhancing governance' which 'focuses on the role of governance in reducing transaction costs to make markets more efficient'. He lists five key governance goals in this policy framework:

- Achieving and maintaining stable property rights;
- Maintaining the rule of law and effective contract enforcement;
- Minimising the risk of expropriation;
- Minimising rent seeking and corruption;
- Achieving the transparent and accountable provision of public goods in line with democratically expressed preferences.

All of these, it will be noted, fall within Adam Smith's minimalist state.

In contrast, 'growth-enhancing governance focuses on the role of governance in enabling catching up by developing countries in a context of high transaction cost developing country markets. In particular, it focuses on the effectiveness of institutions for accelerating the transfer of assets and resources to more productive sectors, and accelerating the absorption and learning of potentially high-productivity technologies' Khan (2007: 4). Khan lists three key institution-building goals in this context:

- Achieving market and non-market transfers of assets and resources to more productive sectors;
- Managing incentives and compulsions for achieving rapid technology acquisition and productivity enhancement;
- Maintaining political stability in a context of rapid social transformation.

Khan's empirical work finds that market-enhancing governance, as measured by the standard Knack-IRIS[5] and Kaufman[6] indices of institutional quality, is statistically unable to distinguish between successful and unsuccessful developing countries.[7] In contrast, he argues, historical inspection of experience with 'growth-promoting strategies' in the 1960s and 1970s strongly suggests that growth-enhancing governance was a necessary condition for the success of those strategies in East Asia, and its absence was the main reason for the failure of the strategies in Latin America and South Asia.

The governance characteristics identified by Khan as growth-inducing include:

- Government agencies must be able to impose discipline in the policy-driven allocation of resources in the same way that competitive markets discipline firms – that is, non-performance leads directly to withdrawal of resources (Khan, 2007: 16). 'Growth-enhancing governance [in success stories] required monitoring resource use and withdrawing resources or support from sectors or firms that proved to be making inadequate progress. … The difficult part of growth-enhancing governance is to implement and enforce difficult decisions about resource withdrawal when performance is poor' (Khan, 2007: 17).
- There is no particular unique set of governance capabilities applicable to all countries; rather, 'the governance capabilities have to be appropriate for ensuring that the growth-enhancing interventions are effectively implemented and enforced' (Khan, 2007: 16).
- Some minimum level of centralisation is required: 'the agencies involved in monitoring and enforcement are sufficiently centralised to be able to internalise all the costs and benefits of implementing the strategy' (Khan, 2007: 17).
- Enforcing difficult decisions 'requires a compatibility of the required governance tasks with the internal power structures of the country. … Growth-enhancing governance is helped if political factions are too weak to protect non-performing industries and sectors. If political factions are strong and there are many of them, its becomes relatively easy for failing firms to buy themselves protection by offering to share a part of their rents with factions that offer to protect them. … [However],

growth-enhancing governance can be moderately effective even in the presence of strong political factions, provided there is a political settlement that allows the political demands of factions to be satisfied through centralised transfers. This can reduce the incentive of factions to capture rents by protecting rent-recipients who are willing to pay. …' (Khan, 2007: 17, 19).

All the above characteristics fit well with the social-corporatist arrangements common in small states. Smallness in and of itself often imposes the centralisation, political settlement and unsustainability of factional resource battles that are the aims of Khan's governance programme.

Where Khan's approach falls short is its implicit closed economy starting point and the resulting focus upon growth in GDP per capita as the overarching aim to which strategies and governance arrangements are oriented. In the open-economy setting, the relevant goals are growth in consumption and in wealth (access to long-term consumption), neither of which bear any necessary close link with domestic production as measured by GDP.

The details of economy-enhancing governance that apply to small states thus differ from Khan's menu in matters of detail, even if some of the central pillars are the same:

- Centralisation of decision-making in a context of a strong consensual political settlement that underpins the legitimacy of the collective agencies that drive and direct resource allocation into high-productivity uses;
- A focus on rapid learning and adaptation to respond to external threats and opportunities;
- Ability to take and implement hard decisions when external resources fall away.[8]
- Solidarity overriding factionalism at times of crisis, providing a resilience of civil society in the face of the sort of shocks that would destabilise politics in larger entities.

7

Conclusions

Looking in very small developing countries for replication of the Scandinavian model of a welfare state may result in disappointment, if credence is given to the proposition in this paper that there is a qualitative threshold of smallness around the one million population mark below which social, economic and political formations acquire a distinctive character. The classic welfare states of Europe are large relative to the group of states and territories that are the subject of this paper.

The personality of the modern state in many very small jurisdictions flows from key events that took place in the era of global decolonisation from 1950 to the 1980s. The nature and purposes of government in small states have been defined historically by metropolitan powers exercising strong influence via colonial rule.

The role of government in small states certainly has a defensive dimension, but it also has a strategic orientation. The combination of a large government sector relative to population, often plus a limited productive base, left post-colonial small state economies quite reliant upon state employment and aid funding.

There is, in short, scope for comparative investigation of what the balance is in individual small states' policy-making between the defensive and the proactive bases for government transfers, in-kind benefits, and wage and salary payments. This clearly will require a good deal of sifting of country-specific qualitative, as well as quantitative, information.

Appendix

Quantitative Indicators Relating to the Welfare State in Small States

To develop and document the issues raised in this thematic paper, several levels of quantitative indicators can usefully be assembled. In the first instance, the aim would be to get a high-quality set of cross-country data for a single year, preferably 2000. The prospects for assembling consistent time series are less clear, but wherever possible it is desirable to obtain point estimates for earlier years to provide indicative changes over time.

Once the database is set up, expanding it forward as data become available is a worthwhile goal.

The following sets of indicators are potentially relevant:

1. General contours of the formal state sector and its role in the wider economy

(i) Total government revenue and expenditure on various measurement bases: the basic source is the IMF's *Government Finance Statistics*, Tables 2 and 7 (with functional and structural breakdowns where available), supplemented by OECD and other sources. Data should be in whatever currencies match with other economic statistics for purposes such as taking government expenditure as a proportion of GDP. This probably means that expenditure should be in the local currency of the day (which is what the IMF *Government Finance Statistics* (GFS) use), plus the ability to convert to a common currency such as US dollars. We may also need conversion factors to express expenditure in terms that are comparable to the purchasing power parity (PPP) inflation-corrected data in the major international databases such as the Penn World Tables.

(ii) Government expenditure expressed as a percentage of GDP and gross national income (GNI). The relationship of government to the wider economy would use national accounts data from the IMF, World Bank, OECD, Commonwealth Secretariat and other official sources.

(iii) A government revenue breakdown sufficient to identify the general sources of funding (local taxes, foreign grants and budgetary supplements, local social security contributions, etc.).

(iv) Where social insurance and/or unemployment insurance programmes are operating, as in Barbados and the Netherlands Antilles, data on flows in and out of the fund, together with fund balances, if available.

2. Indicators of the extent of poverty

Indicators of the extent of poverty and other conditions that could motivate establishment of welfare state mechanisms are also potentially relevant. Anticipated main sources are the World Bank's *World Development Indicators* database, *UN Statistical Yearbook*, OECD and country-specific sources, the IMF *Balance of Payments Yearbook* and International Labour Organization databases.

(i) Estimates of per capita average income measured as GDP, gross national product (GNP), GNI and migration-adjusted GNP;

(ii) Breakdown of income sources amongst wages and salaries, operating surplus, offshore income from remittances and overseas investments;

(iii) Human and social development indicators from, e.g., http://unstats.un.org/unsd/demographic/products/socind/;

(iv) Income distribution where available from, e.g., the WIDER database at http://www.wider.unu.edu/research/Database/en_GB/wiid/;

(v) Databases of gender-specific social conditions such as http://unstats.un.org/unsd/demographic/gender/wistat/index.htm;

(vi) Data on unemployment, wages, and participation rates;

(vii) Data on the extent of the diaspora, using the Parsons dataset http://www.migrationdrc.org/research/typesofmigration/Global_Migrant_Origin_Database_Version_4.xls.

3. 'Welfare state' expenditures

'Welfare state' expenditures by the government sector, both national and local, together with indicators of government expenditure on welfare provision and related programmes to underpin social and economic development, should also be taken into account. The anticipated major source is the IMF GFS, supplemented by OECD and country-specific data.

(i) Direct expenditure on social welfare/income support (transfers), expressed in absolute local currency terms, as a percentage of GDP and of the total government budget. Inclusive of (as appropriate) old age benefits, disability benefits, occupational injury and disease benefits, sickness benefits, services for the elderly and disabled, survivor's benefits, family cash benefits, unemployment benefits. See, for example, Naren Prasad's dataset at http://groups.google.com/group/small-states/files;

(ii) Payments into and out of any government-related social insurance fund providing pensions, unemployment benefit, health insurance, etc., again in local currency and as a percentage of GDP;

(iii) Government expenditures on education (at primary, secondary, and possibly tertiary level), healthcare, and public housing and housing subsidies, expressed in absolute local currency terms, as a percentage of GDP and as a percentage of the total government budget;

(iv) Data on active labour market programmes, such as wage subsidies, government work schemes and possibly intervention in the migration/remittance nexus (this component is harder – see separate section on diasporas below).

4. Extent of income support and other benefits to home residents from the migrant diaspora

(i) Size and location of the diaspora, measured as: (i) home-born; (ii) home-ethnic; and (iii) home-national (whatever data are available);

(ii) Migration flow data;

(iii) Remittance flows;

(iv) Estimates of the average income of the total home-born population set alongside the per capita income of the home-resident population.

5. Aid flows and some indication of what part of aid is directed to social welfare, as distinct from sectors such as the military or physical infrastructure

(i) Total aid flows from Development Assistance Committee (DAC) statistics, UN statistics and other sources;

(ii) Aid as a proportion of GDP and of government funding;

(iii) Destination of aid funding by sector/function, as available.

6. General background data on country size and economic drivers, to provide possible explanatory variables in cross-country work

(i) Population from *World Development Indicators* and the *UN Demographic Yearbook*;

(ii) Information to classify the economy's sources of dynamism; see, e.g., Geoff Bertram and Bernard Poirine's balance of payments classificatory scheme in *Island Political Economy*, Chapter 10 in Baldacchino, G (ed.) (2007). A *World of Islands*, University of Prince Edward Island.

(iii) Sectoral composition of GDP.

Notes

1 Besanko and Braeutigam (2005: 113–116) show analytically the case for vouchers over subsidies in the provision of publicly supported housing. Mill (1910: 8–11) provides the classic statement of the argument that the benefits of education cannot be appreciated until education itself has been acquired, and that therefore relying on the uneducated to choose education *ex ante* will be inefficient. 'It is better to be a human being dissatisfied than a pig satisfied; better to be Socrates dissatisfied than a fool satisfied. And if the fool, or the pig, are of a different opinion, it is because they only know their own side of the question. … Capacity for the nobler feelings is in most cases a tender plant, easily killed, not only by hostile influences, but by mere want of sustenance; and in the majority of young persons it speedily dies away if the occupations to which their position in life has devoted them, and the society into which it has thrown them, are not favourable to keeping that higher capacity in exercise. … Utilitarianism … could only attain its end by the general cultivation of nobleness of character.'

2 For example Prasad (2007: 12) cites Baker's (1992) finding that 'countries with large public sectors have more equitable levels of prosperity amongst the population'.

3 Esping-Andersen (1996: 3): '[T]he advanced Western nations' welfare states were built to cater to an economy dominated by industrial mass production'.

4 Esping-Andersen (1996: 9): '[the welfare state's] ideals of universalism and equality emerged with reference to a relatively homogeneous industrial working class'. The same author notes the organisation of welfare policies around a statistical one-income 'model family'. Both these are faced with disintegration in the post-industrial era.

5 Available at http://ssdc.ucsd.edu/ssdc/iri00001.html

6 Available at http://www.worldbank.org/wbi/governance/pubs/govmatters3.html

7 Khan (2007) points out that most regression studies include developed along with developing economies and obtain strongly positive coefficients. His tables and scatter plots for 1980–1990 and 1990–2003 on pp. 10–14, however, demonstrate that 'converging' and 'diverging' developing countries have essentially the same institutional scores, so that new Washington-style institutional reform is not a sufficient condition for improved growth performance.

8 It is noteworthy that the most dramatic fiscal retrenchment programmes, in terms of mass dismissals of public sector employees, tend to be encountered in small island settings and are carried through usually with minimal political fall-out. One example is the Tongan fiscal crisis of 2006: 'Following a six-week strike in July–August 2005, the government agreed to a settlement with the unions calling for civil service wages to be raised by 70 per cent over two years at a full annual cost of about 7 per cent of GDP. To contain the medium-term fiscal impact of the settlement, the government launched a voluntary redundancy program in the last weeks of the fiscal year ending in June 2006, which resulted in an 18 per cent reduction in civil service staffing – about 3 per cent of Tonga's total labor force' (IMF, 2007: 4). An even more severe fiscal retrenchment and stabilisation programme was imposed by the Cook Islands Government in 1996: 'Between March 1996 and October 1998, the number of public servants declined by 57 per cent. The decline in GDP during 1995–1998 was not matched by an equivalent decline in per capita income. Following the public service retrenchments, many Cook Islanders exercised their option, as New Zealand citizens, to migrate. In the three years from 1996 to 1998, there was a net migration of 3,328 people – 18 per cent of the 1995 resident population' (Asian Development Bank, 2000: 1; see also Gani and Duncan, 2007). The retrenchment cut total government expenditure by one-third from the 1995/96 to the 1996/97 fiscal year, with wage and salary spending falling by 37 per cent. Political stability and the electoral system were maintained without stress through this experience. (In Tonga the retrenchment was followed by riots in downtown Nuku-alofa, but these were linked more to political unrest over slow constitutional reform than with the fiscal squeeze.)

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