

TEN LESSONS FOR ECONOMIC DEVELOPMENT IN SMALL JURISDICTIONS: The European Perspective

by David Milne
February 2000

Published as part of the "Lessons from the Edge" publication series of the North Atlantic Islands Programme

© 2000 David Milne

About the North Atlantic Islands Programme

The North Atlantic Islands Programme (NAIP) is a policy research and action network of islands stretching across the North Atlantic rim. Home base is the Institute of Island Studies at the University of Prince Edward Island.

During its initial phase, from 1994 to 1998, the NAIP focussed on a four-year research project undertaken in collaboration with NordREFO, the Nordic Institute of Regional Policy Research. The intent was for seven islands of the North Atlantic — Iceland, the Isle of Man, the Faroe Islands, the Åland Islands, Greenland, Newfoundland, and Prince Edward Island — to identify public policy proposals aimed at greater economic self-reliance for small jurisdictions. A further objective was to examine political jurisdiction itself as a resource.

The project focussed on research in four main sectors: Primary Resources, Tourism, Export of Knowledge-based Services, and Small-scale Manufacturing. These were addressed through a programme of integrated comparative research, in the context of inter-island exchange and collaboration. The initial phase ended in September 1998 with a conference in Charlottetown, Prince Edward Island, entitled "North Atlantic Forum '98." The lessons learned are also encapsulated in various reports — of which the current publication is one; and most notably in the volume, *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction* (Baldacchino and Milne, Eds., Macmillan, 2000).

In December 1999 two new islands, Cape Breton Island and the Isle of Skye, joined the North Atlantic Islands Programme. North Atlantic Forum 2000 is scheduled for Corner Brook, Newfoundland, September 24–27, 2000.

For more information on the NAIP, please visit the NAIP Web site at <http://www.upei.ca/iis/>.

FOREWORD

In recent years, business and political leaders in Prince Edward Island have demonstrated a growing interest in what lessons of successful economic development might be learned from other smaller jurisdictions across the North Atlantic and within Europe generally. The focus has been on other small islands and jurisdictions of roughly comparable size. This has been the logic for the support provided for the various policy studies of the North Atlantic Islands Programme of the Institute of Island Studies at the University of Prince Edward Island. This report on lessons of economic development taken from a wider European context builds on and amplifies earlier research on North Atlantic islands.

Since the author was resident in Malta during the 1997–98 academic year, it was agreed that he would prepare a report for the Government of Prince Edward Island on lessons of economic development, particularly in manufacturing, from the experience of Malta and a few other select jurisdictions. Given that Mr. Dan Steele, the Study Apprenticeship candidate for Prince Edward Island for 1997–98, was subsequently selected to do his apprenticeship in Malta and to examine manufacturing there, this study will focus much more widely on general lessons of economic development policy (including manufacturing) in a number of smaller European jurisdictions, both island and non-island.

It is important to stress that the emphasis here is on "lessons." In order to be faithful to that objective and to make the report as practical as possible, "lessons" has been used as the organizational framework for the report itself. Hence, each section in this study takes up an important comparative lesson or insight and then tries to see how far it might be brought "home" to Prince Edward Island. Such a methodology, it seems to me, best respects the spirit of learning from the successes, as well as the failures, of other small jurisdictions.

Before moving to the substance of the report, I wish to take this opportunity to thank both the Institute of Island Studies for its boldness and initiative in taking on this challenging international undertaking and the Government of Prince Edward Island for supporting it. I am grateful for the confidence they have invested in me and hope that this report will make a modest contribution to the wider debate on provincial economic policy following the *North Atlantic Forum '98*, the September 1998 conference of the North Atlantic Islands Programme.

David Milne
Malta

LESSON 1:

Moving from Dependence to Economic Self-reliance for a Small Jurisdiction Is Really Possible

Let's begin with the good news. Success is possible. Little places, even very little places, can be viable, and even prosperous. While a few brave scholars of small states have long spoken out against the conventional wisdom that smallness compromises the economic viability of small jurisdictions, especially islands, it has taken a long time for this received wisdom to be debunked and refuted. It will take even longer for these erroneous and widely shared assumptions to disappear from the minds of the public and policy community in Prince Edward Island and many other small jurisdictions around the world. But one can test the swing in establishment opinion just by looking at the trumpeting of small state economic success in the first issue of *The Economist* for 1998; and the lead example for the article is, of course, none other than our familiar partner in the North Atlantic Islands Programme, Iceland!¹

Well, what, in brief, does the *Economist* tell us?

- largeness of scale is no guarantee of prosperity: in fact, only two of the ten largest states in the world enjoy prosperity;
- conversely, smallness of scale is not fatal to prosperity, as many small states enjoy some of the highest standards of living in the world — in fact, Luxembourg, with a population of just 400,000, takes top place for the highest GDP per capita in the world!

In the case of the European micro-states and smaller subnational jurisdictions, in fact, success is the norm. As a group they not only perform as well, but actually outperform their larger, more populated neighbours. While small jurisdictions in Europe tend to be exceptionally successful — reason enough for Prince Edward Island to learn everything it can from them — they are by no means unique. Other small states, such as the island of Mauritius, which has recently achieved economic self-reliance chiefly through encouragement of the manufacturing sector, can offer valuable lessons. After all, the relative success (not predicted failure) of small states is a worldwide trend, as the most complete and exhaustive research of two scholars from the United Kingdom, Harvey Armstrong and Robert Read, has shown so painstakingly. Their findings clearly refute and contradict much of the conventional thinking in this field:

Evidence of the range of GNP per capita values in the 1990s to be found among the micro-states ... [proves] that small size cannot possibly be the universal disadvantage painted by traditional economic theory. . . . The set of micro-states contains disproportionately fewer of the very lowest per capita income categories compared to their large state counterparts. The differences in percentages are quite striking — some 13.4% of the micro-states are in the lowest [income group] compared with no fewer than 36.9% of the larger states. . . . Similarly, 23.2% of micro-states fall into the highest per capita income category while only 17.2% of larger states are in this group.²

LESSON 2:

The Record Shows that the Transition Need Not Take a Long Time

Why not take heart from another "lesson" of comparative work on small places internationally? Virtually all of the success achieved by micro-states and other small jurisdictions in Europe and elsewhere has come *quickly and very recently*. Every economic success story is post-war — indeed most transitions from dependent and have-not status to self-reliance for these jurisdictions have been effected in the last twenty or thirty years. It doesn't matter where you turn — whether it's Luxembourg, or Liechtenstein, Iceland or the Isle of Man, San Marino or Mauritius — there is always a dramatic "before" and "after" snapshot. The "before" cut is a grainy, dispiriting picture of economic simplicity, poverty, or dependence — often a vulnerable monoculture economy built on primary resources; the "after" snapshot shows dramatic new growth, diversification, and resilience.

Of course, there are many small jurisdictions whose economies have not budged from economic backwardness and others that have even gone backwards. Others, like Prince Edward Island, appear to be making significant progress in some sectors, but have not yet turned the corner decisively. The reasons for the variations in performance are varied and complex, as any economic historian seeking to explain the patterns of wealth and poverty among nations, whatever their size, can easily attest.³ Hence, policymakers confront a world where there is increasingly no safety net for any jurisdiction, where economic change can be effected quickly and dramatically, for good or ill, anywhere on the globe, and where success or failure depends upon pulling together the best governing wits and business acumen that can be mustered.

Hence, while there is risk (as always), there is no barrier, no necessary structural impediment, whether visible or invisible, that dooms smaller societies to economic weakness and marginality. Contrary to the funeral dirge emanating from small states literature for decades now, the music in policymakers' ears should be confident, aggressive, and outward-looking. Time is on the side of strategic change.

Better still, in many cases, politicians and parties can even look forward to reasonable returns from the adoption of an effective strategic policy within a couple of electoral terms. Moreover, modern electorates have shown themselves ready to back radical and painful economic programmes if the case for doing so is effectively and persuasively made. Under these circumstances, there should be little patience with self-fulfilling defeatist attitudes that so often limit economic prospects in small jurisdictions.

LESSON 3: A Strategic Plan Involving Local Responsibility and Action

There is an iron-clad "lesson" to be seen in every successful small place: small jurisdictions must assume responsibility and leadership for the development and carrying through of their own programme of economic change. Indeed, there is no dignified alternative, as dependency is a recipe for decay and demoralization. This lesson is so important and contains so many important policy strands or elements that it deserves fuller explication.

All of the examples of economic success in smaller jurisdictions show that the transition from economic weakness to strength comes about when communities actually face the challenge of self-reliance, and decide, often in very different ways, how to move their economy and society forward. This collective stock-taking and reappraisal often takes place against a backdrop of economic and political uncertainty when the promise of success and the threat of failure can be very real. Frequently, strategic economic planning arises when these small jurisdictions come face to face with the fact that they are on their own *either* because they have already moved decisively toward political independence and must assume the economic challenge that comes with that, or because the non-viability of the traditional economy drives them to it. In either case, the political and economic dimensions of the problem are inextricably intertwined.

This was certainly the case with Malta. When it moved toward political independence from Great Britain in 1964, one of its gravest challenges was to find a way to refocus the economy of the island from that of a British naval base in the Mediterranean to a more diversified national economy compatible with its new official neutrality. The nature and direction of the transition were spelled out in a number of early planning documents that drew upon the thinking of outside consultants from the United Kingdom.⁴ These served as the basis for a vigorous and largely successful public policy programme aimed at attracting inward investment in manufacturing. Malta provided among the most attractive incentives for manufacturing concerns in Europe in the form of tax holidays, free or subsidized factory space, exemption from customs duties, and the like. In a review of the history of this aggressive period of economic policymaking, Edward J. Spiteri captured the remarkable employment shift that followed this transition from an older naval economy to a future in manufacturing:

During the two decades [1960s and 1970s], employment in manufacturing rose from 9,690 to 30,519 and employment in tourism from 400 to 3,382. This constituted a development which more than made good for the decline in Services employment which relentlessly drifted from 22,500 to 4,423.⁵

Much of the funding for the transition came from British grants to assist the former colony in making the necessary adjustments, together with renegotiated payments for the British naval bases on the island. In the end, the island's shift into manufacturing and the conversion of the dockyards from military to civilian work were carried out so swiftly and successfully that Prime Minister Dom Mintoff was able to preside over the closure of the British bases by 1979, only fifteen years after independence.

The Isle of Man also used outside consultants to assist with their plans to move the economy of the Isle of Man from reliance upon primary industries and tourism, toward a future in offshore finance. Although the Channel Islands had already begun to mark out just such a transition before the Manx programme got under way, it was plain to see as early as the 1960s the advantages that these smaller jurisdictions offered in lower taxes and less regulation compared to the highly taxed British mainland. While the Manx turned to a low-tax economic strategy in the 1960s almost by instinct rather than by grand design, it was not long before the benefits from this approach began to suggest the need for a more comprehensive and rational strategy of economic growth and diversification into finance, insurance, and manufacturing. These plans came together in a more or less coherent form during the 1970s, with subsequent decades providing a useful learning curve for the Manx as they proceeded with implementation of this economic policy.

In Iceland, there was a gradual process of economic and political improvement as Icelanders assumed more responsibility for their well-being within a colonial relationship with Denmark over the last century; but it was not until full independence in 1944 that the people confronted the hard reality that their economic future would ultimately rest upon themselves. Self-reliance, in that sense, was not a mere philosophic choice, but rather a practical necessity. The country was then one of the poorest in Europe, an agricultural people with a population not much larger than contemporary Prince Edward Island. Economic development in Iceland subsequently proceeded on a much more decentralized community basis than in many other island locations, often with municipal public investment and equity from co-operatives in trawlers, plants, shopping and hotel complexes, and energy systems.

The story of the modern economic transition in Luxembourg, San Marino, or Liechtenstein is broadly similar, where in each case small-sized communities recognized their vulnerability, due to an inadequate level of economic diversification, and took steps in recent decades to transform the economic basis of the state. All three saw a need, for example, to develop a comprehensive strategy that would exploit much lower levels of taxation than those in larger neighbouring states in order to attract high-end manufacturing, together with financial institutions and services; all developed programmes to stimulate tourism as part of the larger effort at creating a successful and diversified economy. Of course, like the Isle of Man, it was up to the local authorities finally to ensure that they could deliver the required policy and regulatory framework that would ensure their genuine competitiveness within Europe and the larger global marketplace.

LESSON 4: **Communities as Actors: Psychological and Legal "Empowerment"**

At the heart of all of these strategies for micro-states and subnational communities lies a profound recognition that their most important resource lies in *the people themselves acting collectively under their own jurisdiction*. It is this consciousness of a community being a real actor in the determination of its own fate that seems to make the most decisive difference. Taking a role as an active agent in one's own economic and political development presupposes two things: confidence in a community that its own actions can make a difference, together with an understanding of what jurisdiction empowers it to do; and a determination to put those legal resources to work on behalf of the community. Such self-conscious activism is virtually a *cultural precondition* for making the best use of jurisdiction as a collective economic resource, whatever the different strategies or legal instruments that small communities choose from time to time.

Yet the primal condition is essentially psychological. There are no real "resources" at hand, even in a community invested with considerable powers to act for itself *unless and until these are understood and are ready to be acted upon by a self-conscious and confident community*. This is a profound lesson to be learned from the record of the most successful European micro-states and subnational communities. It is a reality that strikes any visitor to these thriving smaller communities, just as its absence is so often readily apparent in more depressing, divided places, in the post-Soviet territories, in the third world, and beyond. Of course, having any strong and enduring sense of "community" at all may be a sheer luxury for many modern states that have neither had the benefit of a relatively benign colonial history nor a long history of national integration and maturation. In these circumstances, sermons over community empowerment may seem a cruel joke. Here, the legacy of history and culture will have much to do with the wealth and poverty of nations.

Theorists of small state viability would do well then to consider these factors, instead of relying upon crude quantitative data from macroeconomic theory to project economic and political fortune. In effect, economic theorizing needs the scholarly insights of history, culture, politics, and sociology to do its work. Once political culture is factored in, it becomes easier to understand the remarkable economic achievements of tiny countries like Iceland or San Marino. Both, for example, have had more than a thousand years of experience as distinct communities upon which to build bonds of community and confidence. These foundations translate into durable and mature patterns of identity that can serve these states well as they make their way in a more globalized world economy and international system of larger states. Doubtless it is for this reason that Icelanders and San Marinese look first to their history and culture for explanations of economic success.

For other jurisdictions that lack strong internal confidence, the way will be more difficult, particularly where patterns of dependency upon outside subsidies from metropolitan centres compound the problem. These are well-understood dilemmas in Atlantic Canada. The question is: can the problem of deficiency of confidence and dependency be sensibly addressed in circumstances where the malady is already very deeply rooted? Can public policy play a

constructive role, and, if so, how? Such are the stubbornly intractable challenges confronting economic policymakers in these jurisdictions.

LESSON 5:

Making Imperialism Pay: How Small States Can Sometimes Turn the Tables on the Large

We are accustomed to think of the power relationship of the small to the large in very simple terms. One way or another, sheer common sense seems to tell us that the large will get the better of the small. We find it easy to give examples where this is true, where the soundness of our common sense is borne out. For this reason, we can sometimes be inclined to accept, almost at face value, clichéd, one-dimensional patterns of thinking. Imperialism, then, becomes conceived as a one-way relationship where imperial power always trumps and dominates. This may be morally satisfying fare for the conspiratorially simple-minded, but it won't do as a picture that purports to do justice to the actual complex relationships between the large and the small in the real world. This is true whether we are speaking of the relationships of large and small states, or, in fact, the subtleties of any other human interactions based on scale.

So whether we are speaking of any particular dimensions of size — in territory, natural resources, population, military force, or economic might — any pecking order of these variables among states will never line up with actual outcomes or power-positioning that we might see among states in the real world. The outcome of the Vietnam war, for example, defies predictions based on mere size, as do so many other outcomes in war and international politics. Why then should there be surprise among analysts that small economies can do well, and even outperform the large? If we are to make sense out of these complexities of experience, clearly we have to free ourselves from simple-minded fallacies.

In the case of the small European micro-states, for example, the record shows that, while these states, living in the shadow of much stronger neighbours, have to guard their sovereignty and freedom of action constantly, they have often been able to convert smallness into an advantage in bilateral negotiations with larger mentor states and organizations. This paradox should not be altogether surprising, since analysts have long understood in negotiation theory that, under certain circumstances, weakness can often be converted into strength when the onus is placed upon the stronger and more flexible party to make the concessions needed to achieve agreement. As noted by Armstrong and Read, this paradoxical pattern may account for the surprising success that most European micro-states have enjoyed in bilateral negotiations with bigger players, including the EU:

Many micro-states have been highly successful in securing asymmetric (non-reciprocal) bilateral trade concessions with larger countries and regional trading blocs contrary to expectations, given their small size and weak bargaining power with respect to larger trading partners. One explanation for the willingness of larger countries and trading blocs to offer such preferential trade arrangements bilaterally is that their cost to the preference donor is likely to be negligible. For the micro-state beneficiaries, however, the value of these preferential concessions may be significant in that they provide greater assurance of market access and reduce the risk associated with niche export strategies. The European Union, for example, has been especially generous in its willingness to grant such bilateral concessions to micro-states in Western Europe (Armstrong

and Read, 1995). These concessions have tended to take the form of non-reciprocal free access to the European Union market and derogations for some sensitive products.⁶

Sometimes, the explanation for a small state securing favourable trade relationships comes from the small state's knowledge and exploitation of its economic and strategic importance to its larger neighbours. Luxembourg, for example, sandwiched between Germany and France, held important bargaining power in bilateral trade, despite its small size, because of its large iron ore resources and because of its geographical and physically strategic placement. For these reasons, it was able to secure German investment capital and markets for the development of its steel industry in the nineteenth century, and other trade advantages from the French after the First World War in the twentieth century. Playing off the big powers to suit its own interests has been a long and profitable game of negotiations for Luxembourg, a strategy that continues today with its careful pursuit of European integration that nonetheless respects state sovereignty and tolerates a fair measure of asymmetry.

San Marino, too, has been successful in working out attractive bilateral trade and commercial arrangements, even though its tiny area is totally encircled by Italy. Protecting its independence has been a constant preoccupation for nearly two thousand years, yet San Marino demonstrates a remarkable capacity for survival alongside larger and more powerful neighbours. Its economy thrives on its asymmetrical trade and financial arrangements with Italy and, more broadly, the European Union. These arrangements, providing for open market access to the continent without compromising San Marino's right to set its own tax and regulatory regime to attract inward investment, have been astonishingly successful.

Sometimes, as in the case of Malta, the small state has been able to force the withdrawal of the mother country's former political and military imperium, and at the same time demand substantial transitional payments to assist the new country to find its feet economically. Grants for transitional assistance in the 1960s and 1970s were critical in the success of Malta's bid for attracting manufacturing enterprises to the island, just as were increased levies for the British military base on the island, especially those negotiated by Dom Mintoff in the 1970s. In fact, the Labour Prime Minister in the 1970s played the big powers off against one another with a vengeance in his flirtation with communist states and with Libya, while simultaneously seeking the maximum advantages from western powers. None of this bold adventurism was supposed to figure in the calculations of traditional theorists of small, dependent societies, but it happened nonetheless.

That should be a lesson to leaders in both small and large states.

LESSON 6:

Exploiting Jurisdiction to Create Your Own Competitive Economic Space

In this lesson, we show how jurisdiction can be used to open up a competitive economic space for small islands and states. Accomplishing this trick requires attention to two sides of the small state economy. The first and most important is the *securing of access to external markets* for trade in goods and services, and for investment; the second is the *reshaping of their own territorial space to make it as competitive and attractive as possible for building strategic*

sectors. This is the essential duality, the external-internal dimensions and interrelationships of the small-state economy.

Because of built-in limits respecting market size, resources, labour, and capital, all small states are forced to look outward to the global economy. Because of this higher dependence upon foreign trade for their economic livelihood, it is even more important that the tools for local engagement of the international system be available to smaller, vulnerable jurisdictions. Taking on this role depends critically on how well-positioned a small community is with several different strands of the relevant jurisdictional subject matter. These would include the ability to represent oneself in appropriate international fora, to negotiate/implement/veto proposed trade treaties and the like, and to protect what access has been won. The record shows that small jurisdictions have on the whole faced these challenges exceedingly well, when they have been able to exercise real constitutional leverage.

For example, the Åland Islands, with a mere 25,000 population yet enjoying a unique constitutional status granting them the right to reject treaties affecting them, was in a position to take a separate vote on their relationship with the European Union, despite the fact that the Ålands are part of Finland. As a result, even though Finland had decided to join the European Union, the Ålands were able to use this constitutional power to insist on winning a separate protocol protecting the tax-free status of its ships within EU waters as a condition for its acceptance of EU membership. Jurisdictional muscle here was indispensable in protecting vital external dimensions of its shipping and tourism economy. The Isle of Man, although operating within constitutional convention rather than law, was similarly able to pressure the U.K. government to negotiate a separate arrangement for the island with the European Union, providing for free trade in goods without the shackles of full membership, when Britain decided to join the EU in the early 1970s. This agreement, protected in primary community law, provides the essential access that the island requires for its engagement with the regional trading community on terms that are extremely attractive.

Iceland has remained outside the EU because of threats to its fishery from full membership, although it enjoys appropriate access without these constraints through membership in the European Free Trade Area [EFTA]. The Faroe Islands have taken a similar posture in protecting their waters from EU intrusions, and have retained only a limited bilateral trade arrangement with Brussels, despite the fact that they are legally attached to Denmark, which is a full member of the EU. Other small sovereign states like Liechtenstein, San Marino, and Monaco have also remained outside full EU membership, preferring instead negotiated special arrangements to provide access without endangering their internal policy freedom in other areas. Malta has also taken that route until recently, when the newly elected Nationalist government in 1998 decided to push for full membership with a national referendum to approve the negotiated agreement.

We can conclude from this brief review of the external economy policy of European small states and subnational autonomies that, while there is considerable variation in decisions over the wisdom of full membership in the Union, there is none over the basic necessity of securing appropriate access to nearby regional trading blocs. Arranging outlets for the sale of locally produced goods and services is vital. But the record shows as well that surrendering jurisdiction as a trade-off is itself a problematic exercise that can be justified only where it does not

compromise other similarly vital interests. More often than not, small states or autonomies seek to work out their own special trading arrangements, providing sufficient access on the one hand without unacceptable compromises to their sovereignty on the other. The evidence also shows that smaller jurisdictions seem on the whole to have played the negotiating game rather well, exploiting both their jurisdictional rights and their relative smallness to extract the best deal possible.⁷

Pushing out their economic space well beyond the confines of their small territory has been, however, only one part of the small state strategy. The other side of the equation has been using jurisdiction to make their *internal* space exceedingly attractive to outside capital. The management of this inside/outside strategic economic relationship is complex, not least because these do not operate as separate realms. Instead, they impact upon one another in innumerable ways, and work together to produce an economy's equivalent to a complex, ecological interrelationship. For example, the small state's goal of achieving effective external access to trade and investment not only enlarges its real economic space far beyond its small territory, but it is, at the same time, a central plank in making any small state's own territory economically competitive. Internal and external dimensions of economy should then be seen as complementary and reinforcing processes.

But many other legal instruments beyond trade policy can come into play to help achieve economic competitiveness for a small place. These can include anything from educational to transportation policy, from communications to fisheries and agriculture, from technology to tourism. Enhancing natural and human resources, reducing distance and cost with transit, finding niches of opportunity in a whole variety of economic areas: these are among the most obvious ways of moving forward. But whatever the varied ways in which jurisdiction is put to work in many small places, one of the most ubiquitous and effective instruments for making little places attractive is none other than the *competitive deployment of tax policy*, the subject of lesson seven.

LESSON 7: Putting the Lie to "Death and Taxes"

"Nothing is certain but death and taxes," so the cynical maxim goes. Naturally, we seek to avoid, delay, outwit, or frustrate these laws of pain and disutility as long as possible. While death will not be cheated, taxes are another matter. Here, small jurisdictions may actually come to the rescue, offering relative "havens" from the relentless worldwide hounding of the tax collectors. This, of course, is music to the ears of mobile capital, reputable and not. This then, in a nutshell, is the competitive space that smaller jurisdictions can provide, the tax refuge. In return, capital rewards well-managed Lilliputs with a cornucopia of indirect benefits in the form of jobs, income, economic diversification, and prominence beyond their size and station.

Striking this dangerous bargain, however, is thought by some to be akin to making a pact with the devil. Hence, the unholy alliance of greedy capital and small places seems a transaction of dubious morality or durability. Certainly, it is easy to see why large tax-dependent states might take a dim view of offshore tax havens, and less mobile taxpayers both curse and envy their well-heeled clients. Powerful voices are heard, more or less loudly from time to time, so far more or less futilely, threatening to close down their operations. Yet, despite all the sound and fury, it

seems that this is, in fact, a proven and reliable policy formula for small states in Europe and elsewhere to achieve competitive advantage over their larger, often profligate neighbours. One scarcely knows whether to regard these outcomes as complex morality plays or a species of natural selection. Indeed, is it not fitting to see the proliferation of these ingeniously devised secretive enclaves as perfectly crafted for footloose money in a fluid, ferocious environment of globalization?⁸

While some experts have rightly warned that tax havens and offshore finance centres are no panacea for small states, and that they face increasingly serious threats from larger players,⁹ there is no question that most of the successful small states use tax policy adroitly and vigorously in order to give themselves a competitive edge in the scramble for their fair share of worldwide investment in goods and services. In that respect, it is important to recognize that keeping a low-tax regime is as powerful a force for the development of manufacturing as it is for financial and other services. This certainly has proved to be the case in several of the European micro-states and subnational jurisdictions.

Take San Marino, for example. This tiny country of merely 23,000 inhabitants perched upon Mount Titano not far from Rimini, has managed to build an impressive manufacturing *and* financial services sector by maintaining tax levels well below those in neighbouring Italy and France. As the president of the San Marino National Association of Industry declared, "Companies locate in San Marino principally to take advantage of the very low taxes here [about half that of Italy], and that translates directly into higher profits. With much smaller infrastructure needs on our territory, San Marino continues to stay competitive in taxes when compared with larger states."¹⁰ Payroll costs are lower, import taxes on materials are refunded companies when they re-export, and, since 1991, corporate tax exemptions have grown rapidly as companies take advantage of the incentives for reinvesting profits in the country. Manufacturing consumes some 34 per cent of the labour force in sectors as varied as mechanics, clothing, chemicals and pharmaceuticals, wood products and ceramics.¹¹ Taxation levels, together with a well-managed regulatory regime, also account for the competitive advantage that San Marino enjoys in attracting flows of foreign capital to its financial and insurance sectors, principally from Italy.¹²

The same logic applies in the Isle of Man where virtually all of the economic benefits that have come to the island in recent decades can be seen to flow in one way or another from the creation of an exceedingly low tax environment. Low corporation taxes and business rates; generous capital allowances; the absence of capital gains tax, wealth tax, capital transfer tax, inheritance tax, and death or estate duties; and very low personal tax rates of 15 to 20 per cent, together with generous personal allowances, go a very long way toward attracting both manufacturing and service industries. This tax regime forms the foundation of the island's modern development strategy, whether in offshore banking, insurance, or manufacturing.¹³

In Malta, there has been less grasp of the advantages of a *systematic* low-tax strategy, and no consensus among parties and public for moving toward this route of development. Nonetheless, there has been considerable success, as noted earlier, with a selective incentives programme for attracting manufacturing companies to the island over recent decades. Moreover, Malta has moved up sharply on this learning curve since 1988, when it put in place a highly competitive tax

and legislative framework for attracting offshore financial deposits, a policy that seems to have been successful in giving it a toehold in this sector.¹⁴

Established European micro-states such as Luxembourg and Liechtenstein have pursued financial services and manufacturing using a highly attractive low-tax regime. Although the supporting banking and tax legislation was already put in place as early as the 1920s, it was not until after 1945 that the policies began to take effect. The results have been impressive for both countries in both sectors, although Luxembourg's economy in recent decades has shifted mostly toward financial services, while Liechtenstein has emerged as Europe's most industrialized country.

LESSON 8: The Devil's in the Details

Of course, success in manufacturing and other sectors does not come simply by a state making legal decrees and establishing legislative frameworks for inducing the right kind of private investment. Nor can it come by a jurisdiction simply copying the industrial policy and incentives packages of outstanding models. The jurisdiction itself has to find, from within, the institutions of government and society and the political, administrative, and entrepreneurial resources and approaches needed to make a transitional economic plan work. More often than not, it is at this stage where so many small jurisdictions fall down.

The Faroe Islands, for example, noticing the success that neighbouring small island jurisdictions have had with different strategies, have sometimes tried to shortcut to them. During the period of economic restructuring and modernization in the 1970s and 1980s, they attempted to modernize their fleet and strike attractive trading arrangements for their fish exports like Iceland had done, but, for a variety of reasons, without the same success. The example of the Åland Islands in shipping also did not go unnoticed, and steps were taken, despite profound differences in strategic geopolitical location, to make the Faroes a "hub" for the transshipments of goods and people. These investments did not go well. Even experiments in locally controlled aquaculture failed, as the Faroese sought to convert Norwegian expertise in salmon farming, only to find that most of their small-scale fish farming enterprises couldn't stand up to the sector's rigorous demands for capital, science, and marketing. In the end, aquaculture ended up being consigned to foreign corporate interests, with Norwegians operating this sector within the strict controls for participation of foreigners in the Faroese fishery.¹⁵

The different fates of the islands of Madeira and the Azores in the field of offshore finance is another object lesson that copying the same framework legislation may not bring about equivalent economic results. Both islands are provinces of Portugal, and enjoy the same asymmetrical advantages to operate in the offshore financial industry within overall legislative arrangements set by Lisbon and by the Bank of Portugal. In theory, therefore, both islands enjoy equal opportunity for success with virtually duplicate arrangements. But Madeira has pulled ahead decisively in making itself the Portuguese offshore finance centre. Among the reasons for this outcome was that Madeira was far more organized on the ground, with people in place ready to seize this opportunity in a well-planned series of steps from the early 1980s.¹⁶ The Azores, waiting with the same template of legislative arrangements, has scarcely got off the ground.

The recent economic revolution in Ireland has also sent policymakers in many jurisdictions in a forlorn search for the same kind of dramatic results by merely picking up and instituting the substance of Ireland's incentives packages and programmes. Of course, these make a substantial contribution, but Ireland's success did not come by designing a better industrial policy and then waiting patiently for offshore clients to come to it. Ireland instituted a vigorous programme of identifying and lobbying its larger Irish diaspora to make investments on the island. These and other less-understood "details" in the Irish miracle can be overlooked by jurisdictions that think they can achieve similar success merely by plagiarizing legislative and administrative elements in their incentives policy.

Islands also face pitfalls when trying to replicate other successful strategies, like the free port or export-processing zone strategy that has been so successfully deployed by Mauritius. Here, borrowing ideas that worked remarkably well in Singapore and Hong Kong, Mauritius initiated a policy in the 1970s that encouraged the emergence of "specially zoned manufacturing and processing areas" to spring up all over the island, where entrepreneurs could produce for export, free of red tape and taxes. A free port allowed for export shipping and transshipments to and from the island with the same hassle-free climate. These widely used internal strategies, coupled with agreements providing favourable access to the EU, turned out to be the basis for a hugely successful transition of Mauritius from "sugar-cane island" to "African tiger," boasting a prodigious manufacturing capability. But here again, the deeper reasons for the economic success may well have been the prior successful management of ethnic divisions or the ability to tap into kinship links in South Asia and India.¹⁷ In short, economic success may flow from a people's wider ability not only to manage potentially explosive ethnic problems, but to turn ethnic resources into market advantages.

The best laid plans of public policy may also go awry if the indigenous private sector is not ready to take on the challenges of international export excellence. Certainly, that is the case in Malta, where most local entrepreneurs have been content to carry on as the traditional purveyors of domestic goods and services behind a protected tariff wall, rather than to look further afield for economic opportunity.¹⁸ It is instructive that Mauritius, like Malta, began with an import substitution strategy in the 1960s, but, unlike Malta, departed from it in 1970 in favour of a more liberalized trade model.¹⁹ Mauritius proved more adept, too, in drawing local business people into manufacturing by requiring at least 50 per cent local equity participation in foreign investment enterprises aimed at the international export market. As a result, the indigenous Mauritian private sector is much more export-driven and international in its outlook than is the local Maltese business class, still largely locked into import substitution activities. Obviously, local patterns of acceptance or resistance to international trade and export activity can be a serious factor in economic performance, as the major NAIP study of manufacturing enterprises in the North Atlantic Islands indicated.²⁰

In other cases, it may be the political system that is pivotal to chances for economic success. Certainly, no jurisdiction has been successful with a programme of economic transition and diversification if its political system and public administration have not made themselves *part of the solution rather than part of the problem*. Although the particular political and bureaucratic arrangements and environments vary enormously, effective economic policy in small places depends crucially upon it.²¹ In Malta, for example, virtually every report considering the state of

the national economy has placed part of the responsibility for shortfalls upon the excessive partisanship of Maltese politics, and the bloated size and ineptitude of its bureaucracy. On the other hand, much of the economic success of the Isle of Man has been attributed to the stability and effectiveness of the parliament at Tynwald, the relative absence of political parties, its board system of executive government, and its independent civil service.²²

LESSON 9:

Tapping Physical and Economic Geography: Partners, Hubs, and Diasporas

There has always been much concern for problems of high-cost transportation and peripherality in most salt-water islands. Indeed, this factor has been a ubiquitously noted constraint for the economic development of small, peripheral islands, and has been used as a basis for justifying special subsidies from the centre, such as those Brussels dispenses to peripheral and maritime areas. On the other hand, no evidence has turned up as yet to confirm this systemic disability in the comprehensive statistical study of economic performance of small states and islands by Read and Armstrong.²³

While the special burdens of sea or air transport for islanders have an obviously intuitive, plausible, common-sense appeal, the actual extent of the burden imposed by geography depends critically upon how an island chooses to respond to it. Some islands, precisely because of their geography, have converted weakness into strength, by taking on the access business themselves, and profiting from their mastery of effective sea or air transportation systems.²⁴ The Åland Islands in the Baltic Sea are perhaps the best example of what a tiny island with a population of only 25,000 can do in this regard. They solved not only their own transportation problems, but the bulk of their economic problems by making themselves a shipping "hub" for the transit of people and goods between the neighbouring states of Sweden and Finland. Indeed, their shipping expertise has long been extended to the far corners of the earth, as Åland ships ply the oceans between Australia, North America, and Europe. Here, a successful political economy was built around the alleged disability of islandness.

The same idea of making one's island a "hub" between neighbouring land masses has appealed to the Icelanders, as they seek to place themselves at the hub or transit point between the Old World of Europe and all of the "new found lands" of North America. In their case, it is Icelandair that principally serves to tie together a network of European and North American cities with Keflavik as an entrepôt. A key element in its modern economic success in fisheries, tourism, and other areas has been this ability to use its constitutional leverage to reach out with its national airline and, as noted above, to encompass a wider economic space.²⁵ The Isle of Man likes to see itself as a "hub" between Ireland and the United Kingdom, while Malta considers itself the "stepping stone" between Europe and the vast Arabic lands of North Africa. All of these examples show that islandness need not be construed as a structural weakness, but rather as a strategic strength in particular geopolitical circumstances.

Of course, many would claim with some justification that not all islands are as well-placed for exploiting strategic location for economic purposes as these. Yet, in most respects, the economic geography is not given or obviously disclosed: it is *created*. Iceland seems far too removed from neighbouring landmasses to look like a promising hub. In fact, its relative isolation left Iceland

more or less free from contact with much of the outside world until the advent of air transportation in this century. There is nothing foreordained about the contours of economic geography. In many respects, Malta has failed to take advantage of its strategic geographic and historical "hub" position in the Mediterranean for the development of its economy. And so long as it hasn't made its *island* geography a source of economic strength beyond a naval fortress or ship repair centre, disabilities may continue to outweigh advantages. In short, it is facile to make blanket statements about the one-sided economics of islandness, unqualified by specific circumstances.

As for the landlocked small states of Europe, they have tried as best they can to adapt the "hub" concept in other ways. Luxembourg, for example, not only has exploited its strategic geography beside big-state partners, Germany and France, but it has also made its size and strategic location a basis for making itself a key home for EU institutions like the World Court.

Liechtenstein has exploited its space astride its neighbours Austria and Switzerland. And, of course, Andorra is learning the advantages of straddling France and Spain. In all of these cases, geographic location can be exploited, particularly when jurisdictional freedom permits each to make of its own small adjacent territory a competitive magnet.

Finally, there is a lesson to be drawn from many of the European jurisdictions on how to use their own diaspora to best advantage. Take the Isle of Man, for example. It uses the worldwide dispersion of the Manx people as an asset, both for establishing useful contacts for Manx businesses working abroad, and for attracting back home retired Manx business people who have made good in other countries. Keeping up these networks has proved extremely valuable, particularly since a fair number of the resettled Manx have decided to take up new enterprises again once back on the island.

The same approach has been adopted by many of the other smaller European sovereign states. Iceland, for example, has tapped into its large expatriate community abroad, not only to facilitate contacts and business deals, but also diplomatically, to help project its image overseas with a system of honorary Icelandic consuls that eliminate the need to maintain large and expensive embassies and foreign service staff. These Icelandic networks are present in most of the advanced, developing world and are an incredibly valuable resource. The diaspora is also a major feature of small state or island economies elsewhere, such as Mauritius, where external kinship ties serve as a foundation for its vibrant economy. The same phenomenon, but treated in reverse for many underdeveloped small economies in the Pacific and Caribbean, has been recognized, this time in the form of remittance payments made by immigrant workers in developed countries to their kin back home.²⁶ This important source of foreign income in underdeveloped countries is yet another example of the powerful role played by diasporas in the modern world.

LESSON 10: Manufacturing in Micro-states? Why Not?

Our final lesson from European micro-states returns us to the lessons we learned at the outset, and especially to the importance of thinking free from the shibboleths that might otherwise constrain development options. For even in the tough field of manufacturing we discover little

reason why small places must rule out a future in industrial enterprise. Despite so much dismal theorizing in micro-states about in-built limits to manufacturing because of limited size, resources, labour, technology, capital, and environmental resilience, the fact remains that leading European micro-state models demonstrate otherwise. Not only do we discover that tiny Liechtenstein, for example, is the most industrialized country in Europe with the largest part of its GDP and workforce from this sector, or that Malta's economy owes its life force to manufacturing, but that the diversification strategies of many other small jurisdictions, from San Marino to the Isle of Man, depend upon retaining or building a substantial manufacturing base. Manufacturing in these tiny jurisdictions — typically, targeted, high-end industrial processes in engineering, electronics, and the like — scarcely conforms to the image of mass-scale industry, though long-time steel production in Luxembourg suggests that small states can sometimes even shelter mass industry.

Although manufacturing in micro-state economies is not normally as common a structural component as are financial services or tourism, the small economies that have succeeded best in reducing vulnerability seem to have made the transition to manufacturing.²⁷ Even more telling, the shift to manufacturing in these countries has come quite recently, through deliberate policy innovation, and usually without prior experience in this area. Such success in micro-states in Europe, and elsewhere in places such as Mauritius, shows that the manufacturing sector cannot be ignored. In fact, if looked at from the broader perspective of globalization, this sector is opening up significant opportunities for both developing and advanced micro-state economies as industry increasingly disperses elements of its operations, subcontracts or forms alliances with a myriad of other operators in a production chain that is truly worldwide.²⁷

Moreover, the line between industrial and service industries is becoming increasingly blurred. Small and medium-sized enterprises (SMEs) have become the darlings of modern economic policymaking, as we recognize that they, not the multinational giants of industry, contribute the bulk of employment and economic activity. Under these circumstances, all jurisdictions will want to see what they can learn from industrial showcases like Liechtenstein.

A lovely, rural, canton-sized territory nestled between Switzerland and Austria, Liechtenstein has always projected scenic pastoralism, but high-tech has long since invaded this garden. As Dr. Hubert Büchel, Director of the National Economy, notes:

To an outsider, Liechtenstein might well appear to be a rural area with mountains, forests and meadows, where cows graze. Actually, agriculture and forestry, the primary sector of the economy only account for 2% of the total workforce. In comparison to other industrial countries in Europe, that is a very small percentage. On the other hand, industry and the producing sector, the secondary sector of the economy, account for almost half of total jobs, . . . a very high percentage for a developed economy. . . .

The secondary sector is also very [clean and] diversified. There aren't any factory chimneys in sight! . . . Liechtenstein's industry does not manufacture cheap mass products but only high-tech goods. Liechtenstein has no other option. It doesn't fulfil the basic prerequisites for the sale of mass products on a competitive scale. On the one hand, Liechtenstein has no natural raw materials which would favour the foundation of a basic industry or heavy industry. . . . This is,

however, no longer a disadvantage, for these industries are shifting to threshold countries anyway. On the other hand, the wage level in Liechtenstein is too high to make labour intensive manufacturing processes at all appealing. . . .

The starting point of this development is the shortage of labour and, in part, the lack of land. Shortages, as you know, lead to price increases. That was the case in the early years of expansion in Liechtenstein when wages rose considerably without the unions playing too large a part. And despite wages being high, labour was still short. Simultaneously, there was a great deal of capital with low interest on borrowings. As a result, production automatically oriented itself toward capital-intensive processes which involved great investment in research and development.²⁹

Liechtenstein found its niche, then, in engineering, optical and electronic products, ceramics, pharmaceuticals, chemicals, and the like; and it imported two-thirds of its workforce from neighbouring states. This is a formula not unlike that of San Marino or Luxembourg — in effect, a neat and economical way for micro-states to overcome constraints of labour and land. In addition, many family enterprises in Liechtenstein resolve such shortages by leap-frogging out of the jurisdiction by means of foreign branches. Such obvious adjustments and innovations for enlarging economic parameters appear to have been unanticipated in our small-state theorizing.

The cost of labour and its impact on the nature of manufacturing activity is also a valuable consideration for other micro-state actors. As Mauritius is now discovering, its niche in textiles is becoming increasingly threatened by lower-wage countries, in the same way as Malta's earlier competitive edge in labour costs in manufacturing is being threatened by the rise of competitors in Eastern Europe and elsewhere. The answer, as Liechtenstein indicates, is not for these countries to cease activity in manufacturing, but rather to shift upward to higher value production.

The presence of an indigenous component to Liechtenstein industry is another interesting feature of this model. While there are large multinational firms, there are also domestic equivalents, as well as many local SMEs, providing resilience to the economy. This picture of substantial local participation in export industry is in marked contrast to Malta where the export trade is overwhelmingly in foreign hands. Indeed, almost half of Malta's total export trade is attributable to one single electronics company, ST-Micro-Electronics Ltd. Only diversification within the export sector, both foreign and domestic, can help reduce this kind of dependency and vulnerability, as Mauritius also demonstrates.

CONCLUSION

We have too briefly completed the lessons, all ten. Heavy in symbolism, these are, of course, not in the nature of "commandments." For that reason, many a small jurisdiction will discard one, some, or even most of what has been set out here. For these ten are neither fixed rules, nor rigid theorems. Instead, they are at best "Lilliputian maxims of experience," freely extracted from across time and place. These horizontal practices of prudence and policy are presented as analytic "cuts." As such, no attempt has been made to achieve vertical depth of explanation for economic outcomes in any of the jurisdictions examined, much less to arrive at some supposed, deeper common denominator of success or failure. While interesting patterns have been

highlighted, it must remain the responsibility of every jurisdiction, mindful of its own unique circumstances, to decide what, if any, lessons should be identified, extrapolated, and acted upon. In no case will the maxims ever be simple "ready-made" applications, and in no place will they ever unfold in predictable and uniform ways. After all, it is the contingent and risky character of choice-making in each community that makes finding the right public policy "fit" such an exacting and exciting enterprise. If this report merely helps clear away faulty assumptions and stirs the spirit of innovation in micro-state policymaking, it will have served its purpose.

TABLE 1 Comparative Statistical Data

[Please click to view the table in a pop-up window.](#)

NOTES

1. See "Little Countries: Small but Perfectly Formed," *The Economist*, January 3, 1998, pp. 63–65.
2. Harvey Armstrong, Ronan Jouan de Kervenoeal, Xiao-ming Li, and Robert Read, "The Economic Performance of Micro-states." Islands Conference, University of Malta, May 1997, submitted to *World Development* for publication, pp. 8–9.
3. See David Landes, *The Wealth and Poverty of Nations: Why Some Nations are Rich and Others Poor* (New York: Norton, 1998).
4. See Schuster's study in 1950 arguing for diversification into manufacturing and tourism, and the supporting Baligh and Seers Report of 1955. From 1959 to 1986, six Development Plans followed along the lines of these reports, with Labour and Nationalist governments differing principally over whether the state would be a decisive player in the economic development (Labour) or whether it would merely be a backer and framework setter (Nationalist). These were accompanied by a succession of early studies including the Baynes Report (1960), the Stolper Report (1964), the Robens Report (1967), and the earlier Liebich Report (1963) on Malta Freeport.
5. Edward J. Spiteri, *Malta: An Island in Transition, Maltese Economic History, 1954–74* (Malta: Progress Press, 1997), p. 297.
6. H. W. Armstrong and R. Read, "The International Political Economy of Micro-States: An Overview," paper for the Islands V Conference, Mauritius, July 1–5, 1998, p. 23.
7. See, for example, Nikolas Fagerlund, "Autonomous European Island Regions Enjoying a Special Relationship with the European Union," in Lise Lyck, Ed., *Constitutional and Economic Space of the Small Nordic Jurisdictions* (Copenhagen: NordREFO, 1996), pp. 90–112, for an excellent treatment of the development of the special EU arrangements for the Faroes, the Ålands, and the Isle of Man.

8. See Mark P. Hampton and John Christensen, "Offshore but Heading for the Rocks? Jersey's Offshore Finance Centre Crisis: Fundamental Issues for Other Small Island Economies," Islands of the World V Conference, University of Mauritius, July 1–5, 1998, for an interesting review of some of the debates over the rise of offshore finance centres in the economics literature. See Hampton's most recent extended work in this area in Mark P. Hampton and Jason P. Abbott, Eds., *Offshore Finance Centres and Tax Havens: The Rise of Global Capital* (London: Macmillan, 1999).

9. Ibid.

10. Enzo Donald Mularoni, President, Associazione nazionale Dell'Industria Sammarinese, interview, April 16, 1998, San Marino.

11. See ,i>Associazione nazionale Dell'Industria Sammarinese, *Uno stato e la sua industria nel mondo*, incentives and industrial booklet covering range of San Marino industries, 1994.

12. See *San Marino: Recent Economic Developments*, prepared by Alessandro Prati, James McHugh, and Pierre Gschwindt de Gyor for the International Monetary Fund, July 26, 1996, especially section IV.

13. This is the same point driven home in the conclusions of *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction*, Godfrey Baldacchino and David Milne, Eds. (London: Macmillan, 2000).

14. See Godfrey Baldacchino and David Fabri, "The Malta Financial Services Centre: A Case Study of Dependency Management," in Mark P. Hampton and Jason P. Abbott, Eds., *Offshore Finance Centres and Tax Havens*, pp. 140–165.

15. For a discussion of these and other related development problems in the Faroe Islands, see Arni Olafsson, "Constitutionalism and Economics in the Faroe Islands," in Godfrey Baldacchino and David Milne, Eds., *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction* (London: Macmillan, 2000).

16. The splendid internet site established to promote the island of Madeira and its financial industry provides an extraordinary insight into the history and development of the public policy as an offshore location offering a whole variety of integrated services. It is also a splendid showcase in itself of what a professional, well-designed website can do for projecting and promoting an island abroad.

17. See Henry Srebrnik, "Island by Geography, Crossroads by Ethnicity: Diaspora Peoples and the Development of a 'Middleman' Economy on Mauritius," Islands V Conference, Le Reduit, Mauritius, July 2, 1998.

18. See the *Ramboll Report: Study and Action Plan for the Restructuring of Malta's Manufacturing Sector* (Malta Federation of Industries & Malta Chamber of Commerce, May 1996), which identified this key deficiency in Maltese manufacturing and recommended Malta

move toward EU membership as an antidote. An earlier study by Coopers and Lybrand in September of 1991 for the Malta Federation of Industry looked at *The Effects of EC Membership in Industry in Malta*. For the definitive position of the Labour party, see Alfred Sant, *Malta: The European Challenge* (SKS Information Department, Malta Labour Party, 1995).

19. See James Edward Meade, *Abridged Version of the Meade Report*, 1961, for the pioneering report on strategies of development for Mauritius by Meade, a consultant occupying the Chair of Political Economy at the University of Cambridge. This laid the foundation for industrial development and an export strategy.

20. See Rob Greenwood and Sean McCarthy, "Value Added: Manufacturing Development on the North Atlantic Rim," in Godfrey Baldacchino and David Milne, Eds. *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction* (London: Macmillan, 2000).

21. See the recent edition of *Public Administration and Development* (Issue 18:2, May 1998, edited by Edward Warrington) devoted to the issues and problems of public administration in small states and entitled *The Impact of External Relations on the Domestic Policies and Governing Institutions of Micro-states*.

22. See Will McKercher, "The Jurisdiction of a Crown Dependency: The Renaissance of the Isle of Man," in Godfrey Baldacchino and David Milne, Eds., *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction* (London: Macmillan, 2000).

23. See Harvey Armstrong and Ronan de Kervenoael, Xiao-ming Li, and Robert Read, "A Comparison of the Economic Performance of Different Micro-States and Between Micro-States and Larger Countries," Discussion Paper, Management School, Lancaster University, 1997, EC9/97, Conclusion.

24. The proposition is, of course, not merely a commercial one. It also applies militarily, when special attention is often given to naval or air power for island states.

25. For a brief exploration of the themes of peripherality and constitutionalism, see David Milne, "Placeless Power: Constitutionalism Confronts Peripherality," in *North: The Nordic Journal of Regional Development and Territorial Policy*, Vol. 8, No.3/4, November, 1997, pp. 32–38.

26. Geoffrey I. Bertram and R. F. Watters, "The MIRAB Economy in South Pacific Microstates," *Pacific Viewpoint*, 26 (3), 1985, pp. 497–519.

27. See Robert Read's statistics in his latest essay on microstate economies internationally, especially those that are not dependent upon export of valuable natural resource like oil.

28. For an interesting special feature on the state of international manufacturing, see "A Survey of Manufacturing: Meet the Global Factory," *The Economist*, June 20, 1998, pp. 3–22.

29. Hubert Büchel, "Is There Anything Special about Liechtenstein's National Economy?" speech to LGT Bank in Liechtenstein, Bendern, June 5, 1996, pp. 2–3,5–6.

REFERENCES

"A Survey of Manufacturing: Meet the Global Factory." *The Economist*. June 20, 1998: 3–22.

Armstrong, Harvey W., and Robert Read. "The International Political Economy of Micro-States: An Overview." ISISA Conference, Mauritius, July 1–5, 1998.

Armstrong, Harvey W., Ronan Jouan de Kervenoeal, Li Xiaoming, and Robert Read. "The Economic Performance of Micro-states." Islands and Small States Institute Conference, Malta, May, 8–10, 1997.

Armstrong, Harvey W., Ronan Jouan de Kervenoeal, Li Xiaoming, and Robert Read. "A Comparison of the Economic Performance of Different Micro-States and between Micro-States and Larger Countries." *World Development* 26.4 (1998): 639–56.

Associazione nazionale dell'Industria Sammarinese, Uno stato e la sua industria nel mondo. San Marino, 1994.

Baldacchino, Godfrey, and David Fabri. "The Malta Financial Services Centre: A Case Study of Dependency Management." *Offshore Centres and Tax Havens*. Ed. Jason P. Abbott and Mark P. Hampton. London: Macmillan, 1999.

Baldacchino, Godfrey, and David Milne, eds. *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction*. London: Macmillan, 2000.

Bertram, Geoffrey I., and R. F. Watters. "The MIRAB Economy in South Pacific Microstates." *Pacific Viewpoint* 26.3 (1985): 497–519.

Büchel, Hubert. "Is There Anything Special about Liechtenstein's National Economy?" Speech to LGT Bank in Liechtenstein, Bendern, June 5, 1996.

Coopers and Lybrand. *The Effects of EC Membership in Industry in Malta*. 1991.

Fagerlund, Nikolas. "Autonomous European Island Regions Enjoying a Special Relationship with the European Union." *Constitutional and Economic Space of the Small Nordic Jurisdictions*. Ed. Lise Lyck. Copenhagen: NordREFO, 1996.

Greenwood, Robert and Sean McCarthy. "Value Added: Manufacturing Development on the North Atlantic Rim." *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction*. Ed. Godfrey Baldacchino and David Milne. London: Macmillan, 2000.

Hampton, Mark P., and John Christensen. "Offshore but Heading for the Rocks? Jersey's Offshore Finance Centre Crisis: Fundamental Issues for Other Small Island Economies." ISISA Conference, Mauritius, July 1–5, 1998.

Hampton, Mark P., and Jason P. Abbott, eds. *Offshore Finance Centres and Tax Havens: The Rise of Global Capital*. London: Macmillan, 1999.

Landes, David. *The Wealth and Poverty of Nations: Why Some Nations are Rich and Others Poor*. New York: Norton, 1998.

"Little Countries: Small but Perfectly Formed." *The Economist*. January 3, 1998:63–65.

McKercher, Will. "The Jurisdiction of a Crown Dependency: The Renaissance of the Isle of Man." *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction*. Ed. Godfrey Baldacchino and David Milne. London: Macmillan, 2000.

Milne, David. "Placeless Power: Constitutionalism Confronts Peripherality." *North: The Nordic Journal of Regional Development* 8.3/4 (1997).

Olafsson, Arni. "Constitutionalism and Economics in the Faroe Islands." *Lessons from the Political Economy of Small Islands: The Resourcefulness of Jurisdiction*. Ed. Godfrey Baldacchino and David Milne. London: Macmillan, 2000.

Prati, Alessandro, James McHugh, and Pierre Gschwindt de Gyor. *San Marino: Recent Economic Developments*. *International Monetary Fund*, 1996.

Ramboll Report: Study and Action Plan for the Restructuring of Malta's Manufacturing Sector. Malta Federation of Industries & Malta Chamber of Commerce, 1996.

Sant, Alfred. *Malta: The European Challenge*. Malta: SKS Information Department, Malta Labour Party, 1995.

Spiteri, Edward J. *Malta: An Island in Transition, Maltese Economic History, 1954–74*. Malta: Progress Press, 1997.

Srebrnik, Henry. "Island by Geography, Crossroads by Ethnicity: Diaspora Peoples and the Development of a 'Middleman' Economy on Mauritius." ISISA Conference, Mauritius, July 1–5, 1998.

Warrington, Edward, ed. *The Impact of External Relations on the Domestic Policies and Governing Institutions of Micro-states: Public Administration and Development* 18.2 (May 1998).

AUTHOR NOTE: DR. DAVID MILNE

Dr. David Milne is Professor Emeritus in the Department of Political Studies at the University of Prince Edward Island, Canada. A graduate of Queen's University and of the University of Toronto, Dr. Milne has lectured and published extensively in Canadian federalism, constitutional politics, Maritime politics, and, more recently, in islands and small states scholarship. He has also served as an advisor on constitutional issues to the governments of Prince Edward Island, New Brunswick, and Canada. His books include *The Political Economy of Small Islands: The Resourcefulness of Jurisdiction* (co-ed. with Godfrey Baldacchino. London: Macmillan, 2000), *The Canadian Constitution* (Toronto: Lorimer, 1991, 3rd edition), *Tug of War: Ottawa and the Provinces under Trudeau and Mulroney* (Lorimer, 1986), and *The Garden Transformed: Prince Edward Island, 1945–1980* (co-ed. with Verner Smitheram and Satadal Dasgupta. Charlottetown: Ragweed Press, 1982). Now retired and living in Malta, Dr. Milne continues his work as a freelance professor and consultant in these fields.



Institutions strongly affect the economic development of countries and act in society at all levels by determining the frameworks in which economic exchange occurs. Where transaction costs are small, the private enforcement of contracts may still be preferred. But as economic relations develop and become increasingly impersonal, the role of a third party to enforce compliance to rules is increasingly necessary (Shirley, 2003, p. 2). Property Rights and the Return to Investment. Institutions determine the costs of economic transactions: they spur development in the form of contracts and contract enforcement, common commercial codes, and increased availability of information, all of which reduce the costs of transactions, risk, and uncertainty. Course overview: This course is an introduction to modern Economic History aimed to explain economic development of the globe in the historical perspective. How did it happen that some nations are rich and others poor? Why did some countries forged ahead while the others failed behind? History Lessons: Institutions, Factors. Endowments, and Paths of Development in the New World, *The Journal of Economic Perspectives*, 14(3): 217-232. Culture and institutions: Economic development in the regions of Europe, *Journal of the European Economic Association*, 8(4): 677-716. Voth, Hans-Joachim and Nico Voigtlander (2012). Persecution Perpetuated: The Medieval Origins of Anti-Semitic Violence in Nazi Germany, *Quarterly Journal of Economics*, 127(3): 1339-1392. (Map courtesy of the European Union). To experience this rapid growth, the economies of developing countries must be able to attract inexpensive capital to invest in new businesses and to improve traditionally low productivity. They need access to new, international markets for buying the goods. Theoretical Perspectives on the Economy. Now that we've developed an understanding of the history and basic components of economies, let's turn to theory. How might social scientists study these topics? The functionalist perspective would assume that the continued health of the economy is vital to the health of the nation, as it ensures the distribution of goods and services.