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Big Reasons to Keep Europe Small

by Matthew Kaminski

Back in his day, Mikhail Gorbachev told the Estonians that they were too tiny to survive outside the warm embrace of the Soviet Union. The Estonians, all one million of them, showed him that their size was no obstacle to a better life on their own.

As a small, independent country open to the world and no longer threatened by the bear next door, the Baltic outpost flourished in the intervening dozen years and, next month, will be invited to join the European Union. Just across the border, Russia stayed rich in land and natural resources, and not much else.

In the era of globalization, the Estonias of this world are no longer historical curiosities like Luxembourg or Andorra. And as tiny countries sprout up, old, centralized nation-states also wrestle with pressures to hand power down to local authorities.

This urge to de-merge -- just as the opposite happens with companies -- is particularly pronounced in Europe, and yet deeply distrusted or ignored in the public discourse. The EU's constitutional deliberations are preoccupied with how to empower Brussels after enlargement. Critics claim that the new French government's groundbreaking proposal to devolve power from Paris means the end of the Fifth Republic. Both American and European policymakers are currently resisting the creation of new, ever smaller, states in the Balkans, arguing that they're "unviable" and unstable.

In a world of the big, small countries don't get much respect. I happen to admire them. The Estonians, Latvians and Lithuanians were plucky, brave and frankly obnoxious enough to help bring down the Soviet empire and then sign up to join the EU. Small states are often more democratic and less bellicose. Their economic policies are often smarter since they answer to fewer people and can't afford to waste their limited resources. Big countries tend to be powerful, the small rich. Take your pick.

A hundred years ago, Iceland was Western Europe's poorest nation; today it's among the world's five richest. This wind-swept Arctic island (pop. 270,000) shows when and why -- a maritime metaphor seems appropriate -- the shrimps do better than whales. The keys to its success are free trade, liberal economics and a sense of security.

As Italian city-states in Renaissance Europe, the shrimps also need open borders and protection against external threats to survive. Offering up a good model, Iceland solved both problems by becoming a founding member of NATO (with no military of its own, the U.S. provides for its defense) and striking a free trade deal with the European Union, its biggest market.

With a homogenous population, the government also found it easier to agree on a policy mix that best takes advantage of its greatest resource, fish, which today accounts for 70% of exports and 14% of GDP. As stocks declined in the 1960s, Iceland instituted a unique, market-based system of transferable quotas on fish, even creating a currency unit called the "cod equivalent" to keep track of it all. For example, one haddock is equivalent to 1.2 cod.

With its markets opened and its boats safe in the Atlantic from Soviet subs and protected by a "cod war" truce from British trawlers, the island could specialize in fish. It knew it could trade for everything else it needed. Iceland today has the world's most efficient fishing industry and a bountiful supply guaranteed by regulations against over-fishing. "In Iceland, fishing subsidizes Iceland; in the EU, the EU subsidizes fishing," says Iceland's Fishing Minister Arni Matthiesen sitting in an office that overlooks Reykjavik harbor. "We had to make it work as a proper business."

If Iceland weren't part of the EU "space," it might still be a poor farming outpost. But if Iceland needed to live by every edict from the EU, particularly on fish, it probably couldn't have succeeded either. The EU's common fisheries policy is designed to prop up a marginal, declining industry unable to compete on its own: its insane fishing policies would be economic suicide for Iceland, which is why it hasn't joined the EU.

It's natural that Icelanders know more about fish than EU functionaries. Local knowledge counts for a lot, which is also why devolving powers to local authorities often produces the most sensible policies -- and happens to be a democratic way of making decisions as well. The EU has enough on its hands in running and expanding the internal market to be good at running offshore fishing or legislating on cheese standards in Italy, or generally micromanaging Europe in other ways.

"You see small nations not only survive but prosper on the margins of Europe: they have to keep an open economy and trade with others," says Hannes Gissurarson, politics professor at the University of Iceland. The Swiss are good at banking, the

Irish at attracting foreign investment with low-taxes, the Estonians at running an entrepot trade center with no import duties (until it joins the EU, that is, when they'll go up). Each of them is tied to and protected by the wider Europe. By contrast, Moldova and Albania are small and are the Continent's poorest countries: but they're often stymied in trying to get into EU markets, and maybe one day they too can join the fun.

Small states are not the only ones that can benefit from free trade, transparent politics and peace in Europe, of course. In post-Franco Spain, decentralization coincided with modernization. In England's Yorkshire, the Yes campaign to establish a regional government fashions an argument that business will be able better to shape policies made locally than those thought up in London.

The consolidations of European states in the 19th century, particularly those in Germany and Italy, were driven by a desire to secure borders and create larger domestic markets. (With the protectionist Continent practically closed off to its trading vessels, Britain had an extra good reason to build its Empire.)

But in the modern era of the single market and freer trade, there are no clear incentives for enlargement. Small political units (states or regions) are not only viable but, in many cases, preferable. The sine qua non is to be part of a larger trading bloc, be it the EU or the United States or, one day perhaps, an African Union. In this kind of world, it's easy to imagine an independent Kosovo -- 1.8 million -- as long as it's closely allied economically with the EU and with its neighbors. It would then be easier to imagine a Kosovo at peace with its neighbors, too.

But isn't Balkanization dangerous since it could spiral out of control? "If every European country had 10,000 people that would not be a good idea; they'd immediately start talking about confederations," says Brown University economist Enrico Spolaore, a co-author, with Alberto Alesina, of "The Size of Nations" (forthcoming from MIT Press). "But there is no magic number."

After World War II, the world map cracked many times -- the number of countries rose to 192 today from 74 in 1946 -- and most dramatically in Europe since the fall of communism. European states need not be big or powerful but they do need to be very loosely woven together through trade and commerce to succeed. That's not a message that has really sunk in among the self-appointed Founders of the new Europe just yet.