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SMALL STATES, RESILIENCE AND GOVERNANCE

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Abstract. The purpose of this chapter is to evaluate the Country Indicators for Foreign Policy (CIFP) against small state performance along several dimensions including rule of law, human rights and economic efficiency factors not specified in the CIFP conflict-instability index. This is done by evaluating aspects of governance, specifically democracy, against stability and conflict. Variables relating to the governance of small states are then specified in order to lay out a framework for empirical analysis. Our results indicate that the determinants of governance in small developing states are not very different from those in developing countries.

1. Introduction

Governance as a concept has become increasingly important in economic, social and political debates and, despite extensive theoretical and empirical research on its impact and consequence for development, comparatively little is known about its determinants in general, and even more so in the case of small developing states. This chapter intends to fill some of that gap by conducting an evaluation of the Country Indicators for Foreign Policy (CIFP) against small state performance along several dimensions including rule of law, human rights and economic efficiency factors not specified in the CIFP conflict-instability index. In particular, we examine democracy against stability and conflict and then conduct an empirical analysis of the determinants of governance for small developing states. We build on earlier work by Carment et al. (2006), which used somewhat contrasting cases together with statistical testing, and reported a number of findings about small island developing states (SIDS). As discussed in Carment et al. (2006), first, SIDS have specific and individual vulnerabilities related to their particular economic conditions, governance, international linkages and the environment. Second, in comparison to larger countries, where problems tend to be complex and multifaceted in nature, few SIDS have problems experienced in all areas listed above; conversely, challenges facing SIDS tend to be more localised to specific policy areas. Weak SIDS are prone to low-level political instability and crime-related violence, but in most cases, such instability rarely leads to large-scale conflict. These findings suggest that SIDS in many cases could benefit from policy initiatives targeted at specific and well-defined problems that are not compounded by other risk factors.

Carment et al. (2006) also found that, in comparing the Briguglio and Galea (2003) Economic Vulnerability Index (EVI) with the CIFP conflict-instability index, there are significant differences in the ways the methodologies evaluate both the risks faced by SIDS and the political and economic structures designed to mitigate those risks. For instance, scores for the 10 SIDS included in both Briguglio and Galea's EVI and the CIFP risk index correlate at -0.54. However, when using a modified version of the CIFP instability risk index that includes lead indicators related to 'inherent' structural vulnerabilities, namely demographic stress, environmental stress, population heterogeneity, and human development, that correlation rises to -0.77.

As will be shown in this chapter, the resilience of small developing states (SDS) in general, and SIDS specifically, should be understood in more than economic terms. It will be argued that there are key political and institutional features of SDS that help to mitigate those risks. To evaluate these claims, our current research has moved in two related but analytically distinct directions, namely a focus on fragile states and governance. Each employs its own set of indices, weightings and definitions. Both are related to, but distinct from, the original CIFP conflict and instability index which was used in previous testing. While initial testing allowed us to specify the correlates of instability within SIDS, in this chapter we expand our testing to encompass all small developing states (SDS). Initial results summarised in Appendix 2 show that there is a strong correlation between the Briguglio et al.'s Resilience Index and the CIFP. This is in due part because of the overlapping economic dimensions that are part of both. However, the CIFP governance index taps into other aspects of governance including rule of law, human rights, the capacity of the state to extract resources and the ability of the state to enforce contracts (see Appendix 3 for a full list of indicators).

There is wide variation within the literature regarding the definition of governance. Many attempts say more about those defining the term than the term itself. Some, such as the World Bank, focus on the economic aspects of governance; others, such as the Canadian International Development Agency (CIDA), draw more heavily upon the human security agenda for their definition. CIFP incorporates aspects of both economic governance and human security in its own operationalisation of the term, along with considerations of political stability, the importance of which becomes clear in any study of fragile states. As in its definition of fragility, CIFP derives its definition of governance inductively, identifying the necessary components of functional government regimes and subsequently using structural data to measure their relative presence or absence in each state considered. In particular, CIFP identifies six core components of sound governance: peace and political stability; market and economic efficiency; rule of law; human rights; government transparency and accountability; and popular participation in democratic and political institutions. Deficiency along any one of these dimensions indicates the existence of some deficiency of governance in the state.

The rest of the chapter proceeds as follows. Section 2 evaluates aspects of resilience in the context of governance, especially democracy, stability and conflict. Section 3 examines the characteristics of governance of small states in order to lay out a framework for empirical analysis. Using the CIFP governance index, Section 4 considers the correlates of governance of small states using recent data. The final section puts forward some ideas for future research.

2. Resilience, Vulnerability and Democracy

The definition of good governance adopted in this chapter includes more than just functioning democratic institutions. However, understanding the relationship between democracy and resilience may provide some basic insights as to whether the former is a necessary precondition for effective growth and stability. Though a number of scholars maintain that democratic governance is associated with long-term peace and stability, the relationship between conflict and regime type is far more ambiguous. In other words, non-democratic but long-lasting regimes are sometimes found in states which have achieved a degree of economic and political stability. Certainly, the relationship between democracy and stability is not absolute.

The history of sub-Saharan Africa in the post-colonial period is littered with examples of democratic regimes of varying strength that were overwhelmed by violence, and one need only consider the break-up of Yugoslavia, the recent civil war in Cote d'Ivoire, or the ongoing conflict in Sri Lanka, Colombia and Indonesia to find examples of violent civil conflict occurring in states featuring many aspects of democracy. In each case, any potential pacifying effects accruing from democratic governance were overwhelmed as a result of numerous processes ranging from failed economic transitions, to delegitimisation of reform movements, to the rise of ethno-nationalist movements.

Though some authors continue to support the hypothesis that democracy, when defined narrowly, is inherently peace inducing, the examples above suggest that, barring virtually tautological definitions, any correlation between democracy and civil peace is probabilistic in nature (Saideman et al., 2002). Ultimately, any peace-inducing effects provided by democratic institutions are heavily dependent on the presence of other factors as well (Vanhanen, 1990).

One prominent theory suggests that the level of democracy is significant, with partial democracies, also referred to as semi-democracies, anocracies, intermediate regimes, or unconsolidated regimes, being less stable than either full democracies or well-entrenched autocracies (Huntington ,1968; Muller, 1985; Jaggers and Gurr, 1995; O'Donnell, 1996; Schmitter, 2004). There are a number of variations to this theory. Huntington (1968), among others, suggests that increased civil violence is an unfortunate by-product of the process of democratisation. Others argue that constant instability is not necessarily the result of democratisation, but simply a property of chronically-unstable minimal governments unable to generate a durable polity; such states differ fundamentally from both autocracies and democracies in their ability to manage social transformation without triggering abrupt political change (Gurr, 1974).

Still others, such as Regan and Henderson (2002), maintain that partial democratic regimes tend to face greater threats from opposition groups than other types of states, given the inconsistent nature of popular participation in the state. Partial democracies relax restrictions on civil liberties to the extent that organised opposition groups can form, but maintain sufficient controls on government authority to deny meaningful participation to such groups. Unable to secure a legitimate role in policy formation, such groups may turn to more radical avenues of opposition, creating new threats to the governing regime in the process. The net result, argue Regan and Henderson, is an increased likelihood for government repression and internal violence in partial democracies, a phenomenon they refer to as the inverted "U" hypothesis. Mansfield and Snyder (1995) provide a cogent account of such effects at the interstate level.

An alternative line of reasoning holds that democracy must be combined with relatively robust economic conditions in order to have a peace-inducing effect. Drawing on the rich literature within the field of political science concerning the requirements of democracy that includes classical treatments by Kant ([1795], 2003), as well as more recent formulations by Lipset (1959) and Dahl (1989), such arguments have been referred to variously as the modernisation or development thesis. The creation of a stable and peaceful polity requires both democratic institutions and a robust economy – the absence of either one leaves the states vulnerable to conflict. A number of writers have produced evidence in support of such a thesis. Hegre (2003) provides one recent example. In sum, there is a great deal of ambiguity on the question of whether, and to what extent, democracy is a prerequisite for effective economic development; indeed, it remains possible that democracy is in many instances an emergent property of certain types of economic development. While the literature review above suggests that democracy, nested within a broader framework of good governance, may indeed contribute to stabilisation, questions nonetheless remain. Within the context of SDS, what additional features of good governance are integral to small states? In other words, how are small developing states typically governed, and how do these patterns of governance contribute to – or in some cases limit – economic and political resilience? In the next section, we examine governance with regard to SDS.

3. Governance and SDS

Recent research has found a positive link between the quality of small state institutions and their historical links with the British Empire, their isolation from the rest of the world and their political unity (Anckar, 2006; Srebrnik, 2004). With regard to historical ties, most small states that were once colonies of the British Empire tend to be more democratic than other colonies, while Portugal and Spain's colonies tend to have the worst performance (Anckar, 2004). This idea relates to the diffusion thesis, where democratic patrons, especially those with a parliamentary system, replicated their preference for institutional design, sometimes by force, within their colonies. Also, as Huntington (1968) points out, the length of the colonial period also makes a difference. Indeed, "whereas of short-time colonies a majority are non-democracies, of long-time colonies a majority are democracies" (Anckar, 2004: 219).

Geographical factors are also of prime importance. Where a small state is located near a regional power that has an authoritarian regime, it is more likely to emulate the powerful neighbour (Commonwealth Consultative Group, 1985). Likewise, regional affiliation may have an impact, where African and Pacific small states are surrounded by authoritarian regimes. Finally (and this is the factor often cited as the most significant one), small island states in particular tend to be more democratic than small non-island states (Anckar, 2006). The underlying argument is that their remoteness isolates and, in some way, immunises them from spillover effects of conflicts in neighbouring countries, thus contributing to their ability to implement and maintain democratic regimes (Ott, 2000; Carment et al., 2006). At the same time, small islands are increasingly becoming the targets of drug and arms traffickers, especially when they are located near a continental state (Commonwealth Consultative Group, 1985: 25).

Another potential factor contributing to the quality of institutions in small states is their social cohesion (Read, 2001: 17). They are said to form a homogenous political community, a prerequisite of democracy (Rustow, 1967; Powell, 1982). Polarisation in party politics is largely absent in small states (Sutton, 1987) and inhabitants' identities are usually almost identical to the identity of the state itself (Lowenthal, 1987: 29). This concerted political harmony finds its source in the necessity of fostering in-group solidarity against constant external threats. As a manifestation of this communal bond and political rectitude, parliamentary elections or referendums are often found to be illustrative (Alapuro et al., 1985: 23). Similarly, significant vertical as well as horizontal inequalities seem to be less likely in small states (Sutton, 2007; Streeten, 1993), thus greatly reducing the risk of internal strife. However, even if group conflicts are rare, once they break out, communal animosity may persist for a long time, resulting in a breakdown of social unity. This is especially true if, contrary to Lijphart's (1977) assumption, power parity exists among only a few social groups. Accordingly, power imbalance is found to be conducive to democracy (Dahl, 1971).

One might wonder if positive effects related to state size could over the long run outweigh the negative effects. In the end, it may come down to the fact that many small states have recently declared their independence and thus have relatively immature institutions. Most of the literature on small states has dealt with foreign policy and economic issues, while the identification of the specific factors explaining the quality of their domestic political institutions has been largely neglected. Indeed, although some work has been done on historical and geographical determinants and on the dependent variable – governance – most of our claims remain hypothetical.

Overall, a preliminary assessment of plausible explanatory variables suggests that, as Baldacchino and Bertram (2007) note, hybridisation is a common feature of small states. More precisely, when the analysis moves from the macro to the micro unit level, dichotomous forces arise, which lead to the development of the vulnerability/resilience paradigm elaborated by Briguglio et al. (2006). Their assumption is that the origin of vulnerabilities is exogenous and mostly determined by international economic considerations, whereas the capacity to adapt is internal and dominated by socio-psychological traits. However, some exogenous forces may increase small-state capacity to effectively respond and, as noted above, inversely endogenous elements may well exacerbate an already precarious situation (Baldacchino and Bertram, 2007). Ultimately, research must focus on the relative magnitude of factors that are either conducive or detrimental to good governance, while trying to integrate previous findings, a task that is too often disregarded (Sutton, 2007: 3; Lowenthal, 1987: 34; Amstrup, 1976: 176).

Small states are confronted by a unique combination of inherent economic vulnerabilities resulting from their scarce resources (land, primary commodities, labour, capital and entrepreneurship) and small domestic markets (Briguglio, 1995; Armstrong and Read, 2002; Selwyn, 1975). Over-specialisation, dependence on external trade and capital, constant intrusion of the state in the domestic economy and limited capacity to deliver public goods are themes common to many SDS (Commonwealth Secretariat/World Bank, 2000). In others words, small states face serious constraints in their economic development that tend to erode the quality of their institutions, with respect to the level of corruption, regulatory practices and government effectiveness. At the same time, these constraints are to some extent counter-balanced by specific context factors. For instance, the fact that small-state inhabitants, by their very nature, are closely related to one another, when coupled with the social necessity to survive, can have a variety of impacts on the state, potentially strengthening the rule of law, reducing political instability and giving the citizenry a voice to hold political leaders accountable.

First, the industrial base of many small states is confined to one or two dominant sectors. Their narrow domestic markets minimise their ability to reach economies of scale, which have long been identified by the economic orthodoxy as a prerequisite for a diversified industrial structure. Thus, industrialisation as an engine of growth is a phenomenon largely absent in small states. Given that theories of modernisation, dependence and capitalism emphasise a positive association between economic development and the practice of democratic politics, small states would be expected to have poor governance practices.

Although divergences exist concerning the specific dynamics at play, the main argument of those proponents linking economic development and democracy is that manufacture-based industrialisation leads to the emergence of an educated, organised, middle-income working class which acts as a counter-power against traditional elites (Lerner, 1958; Lipset, 1959; Schumpeter, 1947). The central idea is that industrialisation favours the diffusion of centres of power in a society, creating favourable conditions for the emergence and consolidation of democracy and good governance practices (Dahl, 1971; Vanhanen, 1984). Accordingly, it suggests that small-state institutions are expected to be highly centralised.

For instance, there is a preference for monopolistic positions (Sutton, 2007), where few powerful groups with vested interests co-opt the political agenda, leaving the concerns of the majority aside and inducing parochial behaviours from political representatives (Payne, 1984). Moreover, extreme specialisation is detrimental to inter-industry linkages (Armstrong and Read, 2002; Selwyn, 1975: 78), that are in turn presumed to foster peaceful and consensual behaviour by raising the cost of conflict (Humphreys, 2002).

That being said, an assessment of the degree of diversification in small states might reveal a contrasting picture when disaggregated (Brookfield, 1975). For instance, inhabitants of small states often have more than one source of income at a given time that may also change over time; an aspect of the labour market not easily captured in macroeconomic statistics (Baldacchino and Bertram, 2007: 4). Beyond the resulting methodological problems, such a fact implies that individuals have interests in multiple dimensions of society and thus contribute to its socio-economic diversity to a greater extent than conventional political economic theory might predict. In combination with the direct access to governing elites, ordinary citizens of small states may enjoy a remarkable degree of democratic voice (Farrugia, 1993). Indeed, even in situations of low economic diversification we would expect that small-state leaders are held responsible for their actions, and that there is place for divergent voices and accountability.

Conversely, strategic flexibility and societal intimacy may prove detrimental at the institutional level. Lowenthal (1987: 40) stresses that "where everyone is related, personal involvement in public affairs is inevitable and nepotism unavoidable." Sutton (1987: 16-17) also argues that "in small societies it is relatively easier for a determined, unscrupulous individual... to dominate all or most aspects of the country's life". This argument points to the idea that influence is a two-way street: if citizens can easily influence policies through personal contact with high-ranking civil servants, a despotic leader can also quickly modify or reverse emerging institutional patterns of accountability using the same informal networks.

Second, many small states are dependent on the export of natural resources to few destinations (Amstrup, 1976; Commonwealth Consultative Group, 1985). On this subject, the literature on resource rents tends to converge toward the recognition of their negative effects on the quality of institutions (Luciani, 1987; Karl, 1997). The main argument is what Ross (2004) has called the taxation effect. When the central government extracts the majority of its revenue from non-tax sources—tariff and non-tariff barriers—it tends to function in autarchy, without consulting the population. Thus, corruption becomes endemic and mismanagement of public funds a recurrent problem (Ascher, 1999).

Moreover, small states generally lack sufficient domestic capital to finance their industrial projects and have limited access to international credit (Commonwealth Consultative Group, 1985). Therefore, most of the capital inputs come as foreign direct investments or aid. In the case of the former, Brautigam and Woolcock (2001: 2) note that "investors seem to be indifferent to the quality of their [small state] institutions," a common situation in the natural resources sector, given that assets are fixed. When multinational firms have to operate in an inhospitable environment, they will likely buy off the loyalty of the strongest party or group in order to secure their investment (Reno, 2004). Rents accruing from such corruption tend to reinforce existing social cleavages by empowering one group to the detriment of others and, more importantly, helping to perpetuate repressive regimes (see our assessment of the Solomon Islands in Carment et al., 2006).

The same can be said about aid. Collier and Dollar (1999) acknowledge the absence of an association between aid and policy in small states, in spite of the effectiveness of aid being positively correlated to the quality of institutions. Brautigam and Woolcock (2001: 5) even advance that a "high level of aid intensity has been correlated with poor quality of [small] state institutions." Thus, it is fair to assume that political elites adopt rent-seeking behaviours, where external funds are used in a discretionary and inefficient way for purposes other than those originally planned.

Again, a more nuanced picture emerges when the scope of the analysis is broadened. Contrary to oil rent-seeking states, many small states have diversified their sources of revenues by expanding their fiscal base through personal income grandisement (Brookfield, 1975; Katzenstein, 1985). However, it is far from obvious that income taxes represent a substantial source of revenue for governments of small states. If it is marginal, the government may well ignore the needs and demands of citizens, preferring to simply reduce or erase their tax rate. However, such a decision may result in weakened governing institutions, particularly if the government tends to respond to the needs of those providing the government's substantive revenue streams while neglecting the needs of most citizens. If some groups benefit from preferential rates (e.g., fiscal paradise), it may well create clashes between the population and the governing elites and nourish political instability.

Ott (2000) makes an interesting point by considering the possibility that, although small states are vulnerable to external influence, these influences might have a positive impact by pressuring governing elites to democratise. For instance, political conditions can be imposed on the attribution of aid or the terms of entry into a regional bloc (Ethier, 2003; Campling, 2006). In case of recalcitrant actors, a direct foreign intervention can even be considered. However, as to the last point, the debate is still open since the academic community essentially deals with counter-factual cases, such as Iraq and Afghanistan.

Third, in small states, the central government is often the single largest employer (Farrugia, 1993: 225). With limited employment opportunities and access to capital, competition for state revenues is fierce, a situation that can foster political instability (Cohen, 1987). Moreover, the resulting patron-client relationships between the government and inhabitants considerably reduce the capacity of the latter to express points of view that diverge from those of the political elites, since those same elites control their wages (Sutton, 1987). Inevitably, such governmental pervasiveness raises the question as to whether state institutions, including the judicial system, are in fact impartial, given that senior officials and judges are likely subject to direct pressure from political leaders (Lowenthal, 1987: 43).

Caution must be used in interpreting the implications of state presence in the economy and society as a whole from proxies such as public expenditure. For instance, a substantial share of public expenditure might take the form of transfer payments from government to households and producers (Katzenstein, 1985: 55). Also, as previously mentioned, individuals may have more than one source of income. An individual may hold a position in the public administration while running a retail shop, leaving some room for an independent opinion on specific issues.

Fourth, the capacities of small states are considerably restrained by international market price volatility and high per capita cost of public infrastructures for which, regardless of size, a minimum outlay is required of all states. Small state capacity is further reduced by environmental vulnerabilities. Such burdens weaken institutions and, if combined with centralised government, will likely result in increased popular dissent. If political elites are unable to meet citizen demands and still want to hold their position of power, one remaining option is to use repressive methods, with the consequent adverse effects on the prospect of democratic institutions. In contrast to such reasoning, however, small states usually have low or no defence expenditures; they also tend to have adequately financed health and education sectors (Armstrong and Read, 2002). On one hand, with the absence of military forces, even if conflict emerges, state repression should be limited to a low intensity. On the other hand, a lack of the power or resources necessary to contain popular unrest may ensure that, once begun, the conflict becomes intractable That said however, historically the military elites have often played a crucial role when present, more often than not to the detriment of the democratisation process, representing a viable alternative force able to replace the government (Katzenstein, 1985: 138). Without such a group, democratic institutions are more likely to persist and flourish.

Finally, to mitigate the adverse effects of openness and volatility, many small states have created stabilisation funds and a public investment bank, as well as limited wage and price increases (Katzenstein, 1985). Thus, at first glance, small states' limited capacity might not be a problem after all. For example, the management of stabilisation funds is well-known, especially in developing countries, to be an opaque process that often goes hand in hand with allegations of corruption.

In sum, small developing states are in important ways distinct from larger, more diverse states. Their limited area, relative isolation, and homogenous social structure all have a significant impact on the economic and political life of SDS. These factors result in significant structural weaknesses with the potential to significantly constrain economic performance; in turn, sub-optimal economic development may impair or even undermine institutions of democratic governance.

However, such weaknesses are in many cases mitigated, if not fully counter-balanced, by the presence of numerous factors that also stem from small states' distinctive situations. Given the contextual nature of these factors, they are often neglected by conventional economic models. With these considerations in mind, we turn now to the quantitative data in an attempt to identify some determinants of governance for SDS, and to specify to what extent these determinants differ from those found among all developing states.

4. Quantitative Analysis of Governance

The idea that weak institutions and limited capacity pose major obstacles to growth and development is now commonly accepted; for example, the World Bank views the fight against corruption and the achievement of good governance as being essential components to its mission to eradicate poverty. During the first three decades after the Second World War, as development economics emerged as a separate sub-field, the development literature did not pay much attention to governance, focusing instead on growth and on poverty reduction. It was not until the 1980s that governance started being emphasised in development circles. As is the case with state fragility, however, governance is also a concept that is hard to define; different definitions exist and most of them include notions of institutions, rules, traditions and values by which authority, legitimacy and capacity of a state are exercised.

Analysts use different definitions depending on the nature and objectives of their studies, with a focus on outcomes, namely decision making, implementation and potential obstacles that can prevent the latter. Different definitions are thus captured by measures such as the rule of law, corruption, bureaucratic quality, expropriation risk, political instability and political risk ratings, to name a few. For example, Kaufmann et al. (2005, 2006) measure governance along six dimensions, namely voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and control of corruption. The different indicators are constructed by means of an unobserved components methodology and they are based on reports from businesses, citizens and expert opinion; the numbers range from -2.5 to 2.5, where higher values reflect better governance ratings.

Kaufmann et al. (2006) in the same vein, define governance as "the traditions and institutions by which authority in a country is exercised for the common good. This includes (i) the process by which those in authority are selected, monitored and replaced, (ii) the capacity of the government to effectively manage its resources and implement sound policies, and (iii) the respect of citizens and the state for the institutions that govern economic and social interactions among them." Interestingly, and of direct relevance to this chapter, goal number 8 of the Millennium Development Goals, which is to develop a global partnership for development, includes commitments to good governance, development and poverty reduction at both the national and international level (target 12) and addressing the special needs of landlocked countries and small island developing states (target 14).

The CIFP project has also devoted considerable attention to the issue of governance and defines it along the following six categories: democratic participation, government and economic efficiency, accountability, human rights, political stability and rule of law (see Appendix 3 for a detailed breakdown of each category). Each of these sub-categories is calculated by averaging scores assigned to different indicators that reflect the latter and range from 1 to 9, with lower scores indicating better governance.

The following paragraphs will focus mostly on the CIFP data, but it is important to point out that the CIFP and World Bank data correlate at around 90%, and this holds whether all developing countries or a smaller sample of SDS are considered. Appendix 1 provides a list of SDS for which data exists on some of the main variables considered in this chapter; due to limited data availability, some of the countries will inevitably drop out of the analysis, depending on the variables that are chosen.

Table 1 compares the performance of these countries relative to other countries along the different dimensions of governance using CIFP data.

A number of points stand out from the Table. First, developed countries have relatively smaller scores, judging by the difference in scores when one goes from columns 1 to 2. Second, looking at average scores, SDS do better overall when compared to developing countries, extremely well in terms of "political stability", but not so well under "democratic participation", and "government and economic efficiency". This again illustrates the uniqueness of SDS, and while the reasons for this are alluded to in the above summary, they definitely deserve further investigation beyond the scope of this chapter.

Table 1
Governance in SDS vs Other Countries using CIFP Data (2002-2006)

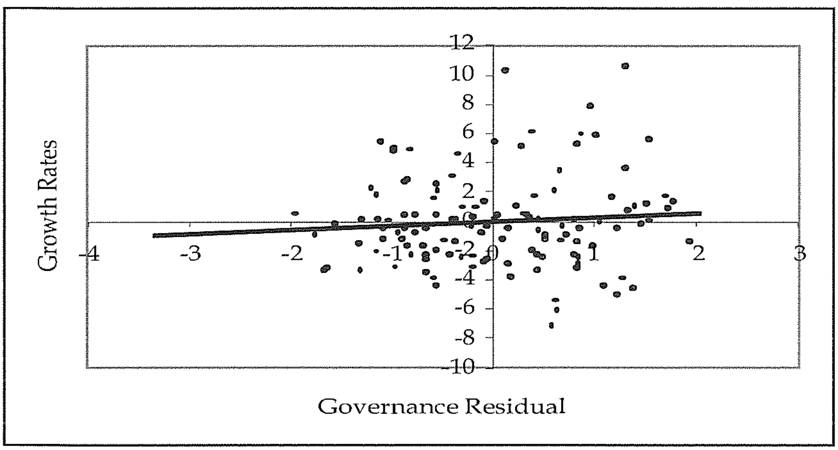
Governance Indicators	All	SDS	Developing Countries
Democratic Participation	5.56	5.96	5.98
Government and Economic Efficiency	5.11	5.45	5.49
Accountability	4.97	5.50	4.34
Human Rights	4.88	5.34	4.04
Political Stability	3.97	4.24	2.74
Rule of Law	5.59	5.98	5.18
Average score	**5.00**	**5.39**	**4.61**

Note: Based on authors' calculations. Developing countries exclude all OECD countries; Small Developing States (SDS) exclude Iceland, Liechtenstein, Luxembourg and Monaco.

As mentioned at the beginning of this chapter, there is an extensive literature, both theoretical and empirical, that has examined the effects of governance on economic growth (and, by implication, on poverty reduction). Although governance and institutions did not receive the attention that they were due (in retrospect) when development economics emerged as a separate sub-field, it has long been recognised that they were important. Recent contributions (for example, by North in 1990) have placed institutions, in the form of property rights and enforcement of contracts, at the centre of development. Statistical studies based on large-sample cross-country analysis have thereafter, by and large, found support for the argument that governance matters in economic development (see for example Barro, 1991; Mauro, 1995; Knack and Keefer, 1995). Barro (1991), using data for 98 countries over the period 1960-85, finds that growth rates and measures of political stability are positively related and, according to him, this may reflect secure property rights; Mauro (1995) finds that corruption, through its negative impact on investment, reduces growth, and that the results hold even when endogeneity is taken into account; using indicators for property rights, Knack and Keefer (1995) find that the effects of property rights on growth are much larger than previously established. All these papers have thoroughly investigated the relationship between governance and growth but, as far as we know, few have investigated the issue specifically with regard to SDS.

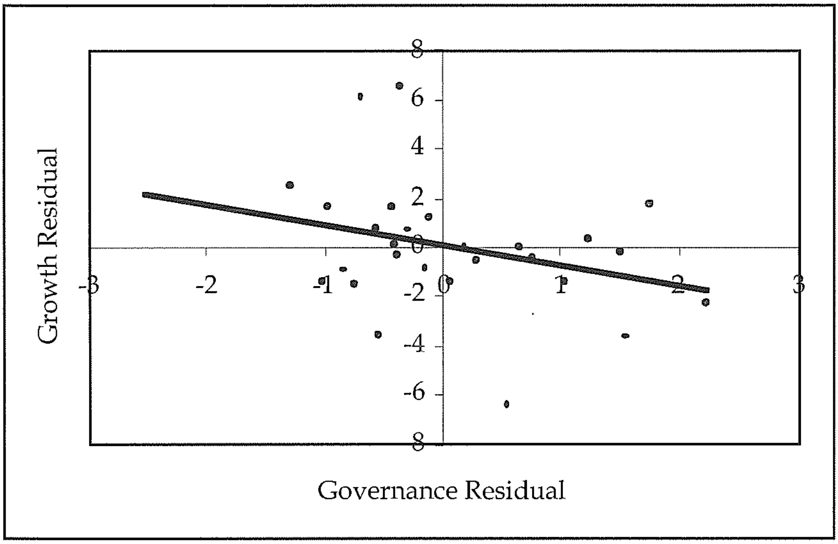
The partial scatterplots in Figure 1 and Figure 2 are quite informative in this regard. Both graphs use the CIFP governance data and growth of real Gross Domestic Product averaged over the 2002-2005 period. Figure 1 shows the partial relationship between governance and growth, controlling for initial income, for all developing countries. There is virtually no relationship between governance and growth, given the relatively flat line; in fact, the governance coefficient related to this scatterplot is not significant. This finding is at odds with the findings by Mauro (1995) and Knack and Keefer (1995) discussed in the previous paragraph.

Figure 1
Growth vs Governance, 2002-2005: Developing Countries



More importantly, however, the same exercise yields a completely different result in the case of SDS, as can be seen in Figure 2. The regression line is negative in this case (even though the regression coefficient on governance is still not significant at the 5% level). Obviously, the results from Figures 1 and 2 are likely to change when more complex models and different time periods are considered. Despite its simplicity, this exercise shows that SDS have potentially unique characteristics that require further investigation.

Figure 2
Growth vs Governance, 2002-2005: Small Developing States



Even if there is a consensus that governance (as defined by CIFP) generally matters for development, and if it is in fact true that good governance has a positive impact on growth and development, the natural question that one should ask is why some countries are characterised by good governance while others are not. In the case of SDS, this is a question that remains largely unanswered, though the present authors attempted to survey the dominant views. Furthermore, the definition of governance that one adopts will determine the independent variables that one should control for.

As mentioned above, different studies have discussed certain aspects of what one would consider as representing governance, for example, the extent of corruption, the impact of property rights, or political stability. In the empirical analysis that follows, the aggregate indicator of governance constructed by CIFP will be used as the dependent variable and construed to be influenced by economic, cultural and political factors (as identified in the review of the literature in the previous section). In particular, the independent variables that are considered are the following:

1. The level of economic development measured as the logarithm of GDP per capita, averaged over the previous five years (1997-2001) to mitigate against reverse causality. This variable is denoted by log(gdppc9701) and follows from the idea that there is a positive relationship between economic development and the practice of democratic politics. In fact, as can be extrapolated from Table 1 above, richer countries tend to have better governance scores, on average.
2. Openness to trade, averaged over the period 1997-2001 (trade9701) is measured by the sum of imports and exports to Gross Domestic Product, and is a standard measure of openness widely used in the literature. It takes into account the possibility that external factors may pressure governments to democratise (Ott, 2000).
3. Ethnolinguistic fractionalisation averaged over the period 1960-80 (denoted by elf6080) is obtained from the La Porta et al. (1999) dataset. We also have a different version for 1985 (elf85) by Roeder (2001). La Porta et al. (1999) find that ethnolinguistically heterogeneous countries tend to have inferior government performance.
4. A dummy variable for countries with the British legal system (British) is also obtained from the La Porta et al. (1999) dataset since, according to Anckar (2004), former colonies of the British Empire tend to be more democratic than other colonies.

One could consider additional controls, but given the number of observations, especially for SDS, this would exhaust valuable degrees of freedom. Because of data limitations, we can only consider the variables that we feel are the most important based on our assessment of the existing literature, leaving the consideration of further variables for future research. Our main objective, once again, is to see whether SDS behave differently when compared with other countries; in other words, are the determinants of governance different for this group of countries?

Table 2 shows the results when the above model is estimated using ordinary least squares and after applying White's correction for heteroskedastity. Columns (1) and (2) show the estimates for the sample of developing countries. The only difference between the two columns is that we tried the two ethnolinguistic fractionalisation indices described above for sensitivity.

As expected, the level of development is highly significant and with the right sign, indicating that the level of development is associated with good governance.

Table 2
Determinants of Governance

Explanatory Variables	(1)	(2)	(3)	(4)
	Developing Countries		SDS	
Constant	9.75**	10.21**	8.87**	9.26**
	(-15.70)	*(-18.67)*	*(-6.22)*	*(-6.89)*
log(gdppc9701)	-0.56**	-0.54**	-0.44**	-0.43**
	(-6.94)	*-7.27*	*(-2.68)*	*(-2.42)*
trade9701	-0.01*	-0.01**	-0.01	-0.01**
	(-1.62)	*(-3.00)*	*(-1.25)*	*(-1.99)*
Elf6080	0.12	-	0.29	-
	-(0.39)		*-(0.52)*	
Elf85	-	-0.55**	-	-0.11
		(-1.87)		*(-0.16)*
British	-0.55**	-0.33*	-0.68**	-0.48
	(-2.96)	*(-1.76)*	*(-1.91)*	*(-1.16)*
N	106	120	32	25
Adj. R-squared	0.49	0.41	0.45	0.42
F-Stat	24.89	20.03	7.28	5.34

Note: t-statistics are shown in brackets. * significant at 10%; ** significant at 5%.

Openness to trade is also a significant factor and with a negative sign, confirming the hypothesis that external factors tend to put 'positive' pressure on governments. The British legal system is also a significant factor.

When only SDS are considered (columns (3) and (4)), the level of development remains significant, although less so than in the larger sample. Openness seems to be less important as one compares across similar specifications, and the same applies to the British legal system. One needs to be careful not to overstate these results, however, given the relatively small sample size for the SDS sub-sample. Future investigations should be able to confirm these results. Overall, based on the results reported here, there does not seem to be a significant difference between the determinants of governance in SDS and in developing countries.

The results in Table 2 do not change significantly when the World Bank data on governance is considered (results not shown here), not surprisingly given its high correlation with the CIFP governance indicator. In order to further investigate the hypothesis regarding differences in the determinants of governance between SDS and other countries, we conducted F-tests (Chow tests) on the sample of SDS versus the sample of developing countries excluding SDS. The computed F statistics did not exceed the critical F values at the chosen levels of significance and we could not, therefore, reject the hypothesis that the regressions are the same. This again confirms that there is not a significant difference between the determinants of governance in SDS and in other developing countries.

5. Conclusions

Through a survey of the literature and quantitative analysis, we have traced the theoretical and empirical characteristics that distinguish small developing states from their larger counterparts with respect to governance. Our findings from the empirical analysis are that the level of development, trade openness and the British legal system are important determinants of governance in SDS, with the level of development being the most important factor. We also found that there is not a significant difference between the determinants of governance in SDS and the other developing countries, whereas SDS tend to be unique in many other ways (see Carment et al., 2006). Future analyses that exploit the temporal (as well as cross-sectional) aspects of the issue, that is, using panel data, thus increasing the sample size, should be enlightening in this regard.

Furthermore, despite the fact that lagged values of the independent variables have been used to reduce the likelihood of endogeneity, income per capita is normally highly correlated with itself over time, implying that endogeneity may still be present and bias the results. Obviously, the way to deal with this problem would be to use instrumental variable estimation, something which we leave for future research.

There is the need for further research to build on the insights generated in Carment et al. (2006), which focused on inherent structural features of small states that cause instability and this present chapter which focuses on governance. As mentioned in the latter, we have found that our governance (and fragility) indices are strongly correlated with the Briguglio et al.'s Resilience Index. A next step would be to disaggregate these indices to find out where exactly they converge and diverge. One such method would be to profile specific countries, using a breakdown of the individual composites to determine points of divergence. In this way, we will be better situated to explain the conditions under which an economically resilient state is likely to experience good governance and when it is not.

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Appendix 1
Small Developing States (SDS)

Andorra	Kiribati
Antigua and Barbuda	Liechtenstein
Aruba	Luxembourg
Bahamas	Maldives
Bahrain	Malta
Barbados	Marshall Islands
Belize	Mauritius
Brunei Darussalam	Micronesia
Cape Verde	Monaco
Comoros	Palau
Cuba	Papua New Guinea
Cyprus	Qatar
Djibouti	St Kitts and Nevis
Dominica	St Lucia
Dominican Republic	St Vincent and the Grenadines
Equatorial Guinea	Samoa
Estonia	São Tomé and Príncipe
Fiji	Seychelles
Gabon	Singapore
Gambia	Solomon Islands
Grenada	Suriname
Guinea-Bissau	Swaziland
Guyana	Timor-Leste
Haiti	Tonga
Iceland	Trinidad and Tobago
Jamaica	Vanuatu

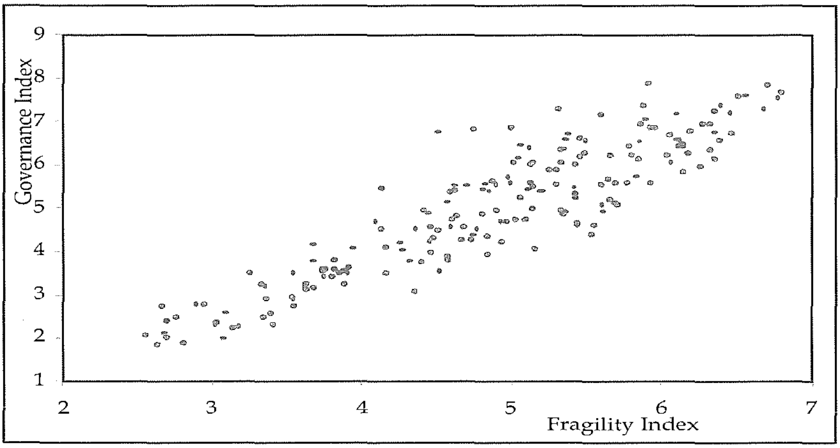
Note: The list above includes small developing states (SDS), small island developing states (SIDS) and countries with a population of 1.5 million or less, for which data were available.

Appendix 2
Correlation Matrix of the CIFP Fragility Index, the Governance Index and Briguglio's Vulnerability and Resilience Indices

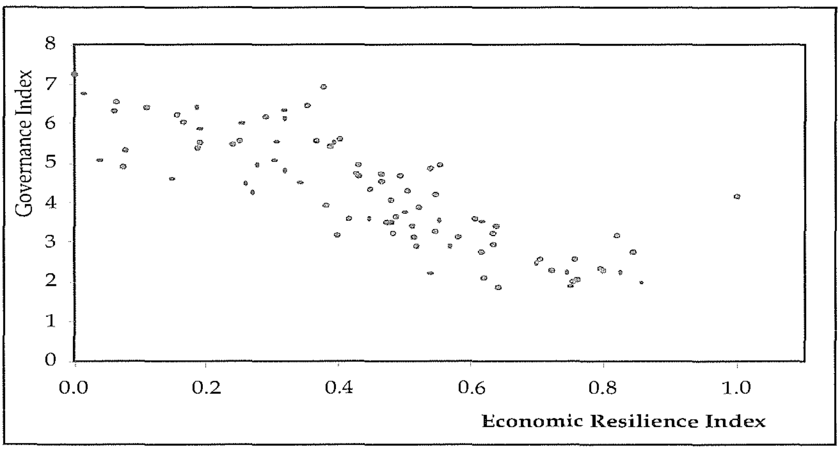
	G	F	R	V	C
Governance (G)	1.00				
FS Index (F)	0.95	1.00			
Resilience (R)	-0.84	-0.88	1.00		
Vulnerability (V)	0.06	0.10	-0.07	1.00	
Combined (C)	0.60	0.66	-0.71	0.75	1.00

(N=87)

Governance vs Fragility



Governance vs Resilience



Appendix 3
List of Clusters and Indicators in the CIFP Governance Index

1. **Democratic Participation**
   Checks and Balances (World Bank Database of Political Indicators, Index 1-5)
   Degree of Party Dominance (WB DPI, ratio of opposition to govt members)
   Percentage of Female Parliamentarians (WB WDI)
   Level of Democracy (Polity IV, Index, -10-10)
   Executive Constraints (Polity IV, Index, 1-7)

2. **Government and Market Efficiency**
   Economic Growth: Percentage of GDP (WB WDI)
   Economic Size: Relative, GDP per capita (WB WDI)
   Economic Size: Total, GDP (WB WDI)
   External Debt: Percentage of GNI (WB WDI)
   Ease of Doing Business: (WB Ease of Doing Business, Global Rank)
   Starting a Business: (WB Ease of Doing Business, Global Rank)
   Protecting Investors (WB Ease of Doing Business, Global Rank)
   Trading Across Borders: (WB Ease of Doing Business, Global Rank)
   Closing a Business: (WB Ease of Doing Business, Global Rank)
   Economic Freedom: (Heritage Foundation, Index, 0-100)
   Savings Level: (WB WDI, Gross Domestic as a % of GDP)
   Foreign Investment Freedom: (Heritage Foundation, Index, 0-100)
   Intellectual Property: (Fraser Institute, Index, 0-10)
   Investment Climate: Contract Regulation (Heritage Foundation, Index, 1-5)
   Enforcing Contracts: (WB Ease of Doing Business, Global Rank)
   Dealing with Licences: (WB Ease of Doing Business, Global Rank)
   Registering Property: (WB Ease of Doing Business, Global Rank)
   Enrolment Rates: (UNESCO, Gross enrolment ratio)
   Health Infrastructure: Expenditures as a percentage of GDP (WB WDI)
   Access to Improved Water: (WB WDI, percentage of pop.)
   Government Effectiveness: (WB Governance Matters, Deviation from Mean)
   FDI: percentage of GDP (WB WDI)
   Foreign Aid: Percentage of Central Government Expenditures (WB WDI)

   Inequality: GINI Coefficient (WB WDI)
   Trade Balance: percentage of GDP (WB WDI)
   Unemployment: (WB, Percentage)
   Paying Taxes: (WB Doing Business, Global Rank)

3. **Accountability**
   Corruption: (WB GM, Deviation from Mean)
   Voice and Accountability in Decision-making: (WB GM, Deviation from Mean)
   Freedom of the Press: (FH, Index, 0-100)

4. **Human Rights**
   Restrictions on Civil Liberties: (FH, Index, 1-7)
   Restrictions on Political Rights: (FH, 1-7)
   Human Rights: Empowerment: (CIRI, Index, 0-10)
   Human Rights: Physical Integrity: (CIRI, Index, 0-10)

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5. **Political Stability and Violence**
   Permanence of Regime Type: (Polity IV, Years since Regime Change)
   Informal Economy: Black Market: (Heritage Foundation, 1-5)
   Conflict intensity: (Uppsala PRIO, Number of Conflict-related Deaths)
   Dependence on External Military Support: (Fund for Peace, 1-10)
   Military Expenditure: Percentage of GDP: (WDI)
   Political Stability: (WB GM, Deviation from Mean)
   Refugees Produced: (WB WDI)
   Terrorism: Number of fatalities: (US NCTC, Number of Fatalities)
   Terrorism: Number of Incidents: (US NCTC, Number of Incidents)

6. **Rule of Law**
   Police, Law and Criminality: (WB GM, Deviation from Global Mean)
   Prison Population Rate: (International Centre for Prison Studies, per 100,000 pop.)
   Prison Occupancy Level: (ICPS, Percentage of Official Capacity)
   Number of Political Prisoners: (CIRI, Index, 0-2)
   Judicial Independence: (Fraser Institute, Index, 0-10)
   Impartial Courts: (Fraser Institute, Index, 0-10)

Methodological note: In calculating the CIFP index, each cluster is weighted equally.