Centrifugal world: Why the future is small

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With growing competition between the US and China, and calls for tighter European integration, it is often said that the world is moving into an age of big powers. But this obscures as much as it reveals. The process of 100 years of political fragmentation, with an increasing number of smaller countries, will continue. Smaller countries are likely to be better able to navigate an increasingly complex, turbulent global environment. Although new regional and other groupings will emerge, the ongoing lowering of the decision-making centre of gravity will be a defining feature of the emerging global system (alongside the transfer of power from West to East). Decision-makers should not be seduced by scale.

The world's attention seems increasingly focused on the large economies, suggesting that the future lies in large countries and groupings. The performance and prospects of the US, China, and Eurozone clearly have a substantial effect on the rest of the world. And the decisions of Washington, Beijing and Brussels set the terms of the global debate on issues from monetary and fiscal policy to progress on trade and climate change negotiations.

In the developing world, scale is a particularly dominant feature – China and India with their billions of citizens, and the rapidly growing large countries such as Indonesia, Brazil and Nigeria. The growth of these countries is changing the face of the global economic and political environment. Scale is also reflected in new international groupings, such as the BRICS and the G20, that convene the large economies. Despite the limitations of these organisations as effective decision-making bodies, these new groups reflect the increasing presence of large countries.

Of course, scale has always mattered. But there is a sense that after a period in which national scale was less of a salient feature, economies of scale are returning. In a G-Zero world in which classic multilateralism is fragmenting and weakening, and with growing competition between the major powers, smaller countries have less institutional protection and claims are made that is safety in numbers. Indeed, President Barroso of the European Commission recently argued that "in a world of giants, size matters" – the implication being that tighter European integration is needed for Europe to succeed and to remain relevant.

So is it a world of giants, with just a few nodes of economic and political decision-making? Do countries need to be big to survive and prosper? The short answer is no. Although it is certainly the case that large countries exercise powerful influence, a focus on large scale obscures as much as it reveals. Large countries matter and can act to shape the global system, but it is small countries that are best equipped to adapt and prosper.

To see this, it is instructive first to consider some history. 100 years ago, on the cusp of the World War I, there were less than 70 independent countries. The global order was dominated by Empire. Since then, there has been an ongoing process of increase in the number of countries; the end of Empire and the unwinding of colonial arrangements, and the ending of the Cold War brought spikes in the number of countries. Today there are close to 200 countries.

This powerful dynamic has been supported by the benefits received by small states from the relative openness and stability of the international system over the past several decades. The expansion of a global rules-based order has helped to remove an important source of disadvantage for small countries, enabling them to access international markets. Small advanced economies have been significant beneficiaries of globalisation, and are well-represented at the top of economic and social rankings. And, for most, being small has not been a major security risk – small countries have been able to rely on participation in alliances.

But there are powerful economic and political forces at work that are changing the shape of global economic and political environment. Frictions around globalisation, and the weakening of the multilateral system, create new challenges for small countries in accessing markets and advancing their interests. And in an age of increased economic and political turbulence, it is the larger states that are better placed to absorb the volatility. The crisis has provided many examples of small states that have been hit hard, from Iceland to Cyprus. Small states now look particularly exposed relative to their larger counterparts. Indeed, history suggests that periods in which international openness retreats and instability increases place a premium on fewer, larger economic and political units.

So will there be ongoing centrifugal pressure, with an increasingly distributed world and a lower centre of economic and political gravity? Or will there be a process of agglomeration, with the balance shifting to the large countries and groupings?

To answer this, it is important not to over-interpret the implications of the change in the international environment. For one thing, although globalisation is changing it is not reversing. The global economy is more difficult to navigate, particularly for small countries, but there is no return to protectionism. Small countries are still able to expand beyond their borders in the context of a rules-based system. Similarly, the international political environment is changing but remains recognisable.

But more importantly, many of the attributes of small countries are well suited to this emerging economic and political environment, and will allow them to better adapt to the emerging challenges and opportunities. The strong performance of small countries over the past decades has not just been due to the particular features of the prevailing international environment, and accordingly is not particularly fragile to changes in this environment. The performance is also due to the distinctive characteristics of small countries. And these factors will likely become even more valuable in dealing with the emerging environment.

Although these challenges likely impact disproportionately on small countries, it is also the case that small countries are well-equipped to respond effectively. And indeed, the performance of the successful small advanced economies continues to impress, even in a challenging, intensely competitive global environment. For every Cyprus, there is a Singapore, Switzerland, and Israel.

There are three related attributes of small countries that are particularly relevant.

Political economy: Small countries tend to have higher levels of social capital and trust, better enabling them to achieve a political consensus around a strategic policy direction. There is commonly a greater sense of shared purpose in small countries, which makes it easier to set policies in a way that reflects local preferences. This trust and social consensus enables governments to take the required actions to respond quickly and flexibly to shocks and also to take the actions that are required to sustain competitive advantage. Political decision-making in small countries also tends to be more streamlined and less complex than in large countries, allowing for quicker and better integrated decision-making.

A political culture – and institutions – that allow change to be made in a politically acceptable way will become increasingly valuable in a turbulent, fast-paced global environment where there is a need for ongoing change. Recent evidence of this can be seen in the response of many small countries to the effects of global financial crisis, where there was often a greater ability to take hard decisions involving the allocation of losses and risks across society. In contrast, the more complex, heterogeneous large countries struggle to deliver the sustained political consensus required to achieve structural reform and fiscal consolidation. The need for countries around the world to address many structural challenges in the years ahead means that political economy is likely to be a key success factor for countries – and the attributes of small countries in this regard will be an important source of advantage.

Strategic coherence: Casual examination of small country policy approaches shows that there is no single policy template. Successful small countries deploy a wide range of different policy models (compare Singapore and Hong Kong with the Nordics), and outside of a tendency to conservative macro policy, a stronger external orientation, and investment in knowledge, there are few systematic differences with large countries. But small countries tend to be characterised by a sense of deliberate, coherent positioning, aimed at identifying a distinctive competitive position and aligning a range of policies and other actions behind it. Similarly, small countries are frequently very thoughtful about overall national positioning, and developing a structured portfolio of relationships.

The strong performance of small advanced economies over the past few decades is less due to policy specifics than to this ability to position themselves effectively in response to the challenges and opportunities of globalisation. In a competitive, fast-paced global economy, the ability to identify the way in which the country is going to compete, and to be able to align policy behind this in a way that reflects local context and preferences, is important. The successful countries are those that have a clear sense of their specific competitive advantage, and invest deliberately behind it. This clarity of strategic focus is much easier in small countries than in larger countries that are more diverse and complex, and that tend to focus on broad macroeconomic policy rather than on delivering a coherent competitive strategy.

Similarly, in the political space, small countries in increasingly contested environments – say in East Asia – are responding by investing in regional institutions, as well as by deliberately maintaining relationships with a variety of partners. Small countries are often adept at developing a balanced set of relationships. And small countries can sometimes benefit from being 'below the radar' because they have little ability to threaten or indeed to directly shape the regional or institutional order.

Competitive discipline: Small countries have a demonstrated ability to adapt quickly to changing circumstances in a way that enables them to maintain competitive advantage. This is partly because the greater exposure of small countries to the external environment, and the much more limited margin for error, creates a need to respond quickly. This competitive discipline can be uncomfortable, and can lead to spectacular blow-ups on occasion, but it means that poor policies are less likely to be sustained in small countries. Small countries face pressure to adapt themselves to new opportunities and risks in a timely manner. They have to be serious. In contrast, large countries have a greater ability to continue with poor policies.

This exposure may look like a weakness, but over time it is a source of advantage and leads to better outcomes. Small countries recognise that they need to adapt to the world, rather than expecting the world to accommodate itself to them – a mindset that is seen sometimes in large countries (what George Kennan called 'the hubris of inordinate size'). And consequently small countries are much more focused on the international environment, and doing things as well as possible. This leads to a greater degree of policy experimentation and innovation in small countries. Indeed, it is the smaller economic and political units that set the standard in terms of policy innovation in many areas, from central bank independence, public sector management reform, to free trade agreements.

Overall, small countries are confronted with a more challenging and complex international environment – and have exposures in this regard that are likely more acute than larger countries. But the characteristics of small country political economy, the strategic coherence of policy-making in small countries, and the responsiveness of small countries to external changes, also gives them an ability to respond effectively. Small countries have economic and political systems that allow them to be purposeful, responsive, and flexible. In a more challenging world of turbulence, change, and complexity, this strategic agility of small countries is likely to be increasingly valuable – and hard for larger countries to replicate.

This suggests a more complicated story than an inexorable shift in the global system towards larger countries. Indeed, many small countries seem to adjusting well and continuing to perform. Although there have been some high profile small country failings - Greece and Cyprus provide recent examples – these instances should not be over-interpreted as evidence of a more systematic small country problem. Rather, the balance of evidence suggests that small countries responding: getting their fundamentals into shape, are continuing to invest in research and innovation, are growing into export markets, and are in the vanguard of new trade arrangements.

If anything, it seems that large countries are struggling to accommodate themselves to new economic and political realities. Large countries are finding that they have less policy autonomy and freedom of manoeuvre. Established powers are experiencing the need for a measure of power-sharing with emerging large countries. And globalisation is reaching further inside large economies, impacting many more people and sectors, and reducing the level of domestic policy autonomy. Changes in the global environment are having the effect of reducing the effective size of large economies, making them smaller.

This is a familiar world for small countries, and they are used to responding. But it is newer for larger countries and it may take them time to adjust to this more constrained environment. The failure to fully adjust by large countries may take some time to manifest, because problems can hide for longer in large countries – and they have more policy levers at their disposal to compensate in the short-term, particularly fiscal and monetary policy. But without adapting to this new world, the medium-term performance of larger countries may be compromised and mis-steps are more likely.

The attributes of small countries means that there is good reason to expect that many small countries will continue to perform well. The international system is not on the verge of a reversal of the century-long process of decentralisation. Being small, with policy autonomy, will continue to be an attraction. This continuing attraction is evident in many contemporary debates, such as the debate in Europe about retaining domestic policy autonomy rather than moving to a more integrated, federal model, as well as in the ongoing independence movements in Scotland, Catalonia and elsewhere.

There are some dimensions on which scale does matter, perhaps increasingly: examples include security, foreign market access, exchange rate arrangements, and global negotiations on trade and climate change. But for most small countries, the advantages of scale can be adequately achieved through participation in regional groupings while retaining local policy autonomy on other issues. Indeed, smaller countries are some of the most active participants in these regional groupings; consider the small countries in Europe continuing to line up for euro membership.

For this reason, regional groupings may well grow and strengthen, and a reduction in the number of independent currencies over time seems likely. But while the large groupings will not disappear, the number of effective decision-making units will continue to increase. It will be a more distributed system of decision-making, with a diversity of policy approaches, rather than a model of just a few nodes of decision-making. This may lead to a messier international system, but it has some advantages: greater competition, more policy experimentation and innovation, and more resilience exactly because of the diversity of national policy approaches. The pressure for universal global solutions should be tempered by an appreciation of the benefits of a distributed model.

Of course, what large countries do will continue to matter – for better or worse. The behaviour and performance of large countries has a major impact on all countries, and it is the large countries that exercise disproportionate influence on the shape of the global system. Being at the table, and being in a position of power, is a source of national advantage. Small countries in Asia can do little directly when their interests are threatened by China's expansion – just as small economies are limited in what they can do in response to the massive monetary easing in the US.

But national decision-makers should not be seduced by scale; as well as the benefits from scale, there are important diseconomies of scale as well that impact negatively on the outcomes that large countries are able to generate. And so even as countries try to project a larger presence internationally, care should be taken to fully capture the benefits from distributed policy-making at home to ensure economic dynamism and political sustainability. The decision-making that drives competitive advantage and quality of life will best be undertaken at a more granular level.

Clearly not every small country will be a success, but small countries are relatively well positioned to adapt and prosper. And the attractions and benefits of small scale will continue to drive a centrifugal process, even as regional and global solutions are used for policy issues where scale does matter. On this basis, the century-long process of fragmentation is likely to continue. This will be seen both in terms of an increase in the number of independent countries as well as increased devolution of power within nation states to some cities and regions.

There is much talk of the shift of power from West to East, and from the state to various non-state actors. But the shift of influence from large countries to small countries should not be under-estimated. Small countries may not wield raw power, but as an organisational form that is well-suited to adapting to this new world, they will become increasingly influential nodes of leadership in the international system as a consequence of the superior outcomes they generate. The future is small.

About the author

Dr David Skilling is the founding Director of Landfall Strategy Group. David is Senior Advisor to the Secretary of Foreign Affairs and Trade in New Zealand, is a Fellow at the Civil Service College in Singapore, and engages with several other small countries. David writes regularly on small states and globalisation. Prior to founding Landfall Strategy Group, David was an Associate Principal with McKinsey & Company's Public Sector Practice, based in Singapore, as well as being a Senior Fellow with the McKinsey Global Institute. Before joining McKinsey, David was the founding Chief Executive of the New Zealand Institute, a privately-funded, non-partisan think-tank, which focused on achieving significant impact in important areas of policy. Until 2003, David was a Principal Advisor at the New Zealand Treasury. David has a Ph.D. in Public Policy, and a Master in Public Policy degree, from Harvard University, as well as a Master of Commerce (Hons) degree in Economics from the University of Auckland. He was a Teaching Fellow at Harvard University for three years, and has also worked at the OECD. David was named as a Young Global Leader by the World Economic Forum in 2008.

About Landfall Strategy Group

Landfall Strategy Group is a Singapore-based research and advisory firm that provides perspectives on the shape of the emerging global economic and political environment. The primary focus of our work is on the exposures and policy responses of small developed countries with respect to the global environment. The underlying beliefs are that small countries face distinct strategic challenges and opportunities, which required targeted analysis and advice; and that small countries provide insightful perspectives on the global context.

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