

Regional Disparities in Small Countries

edited by Daniel Felsenstein and Boris A. Portnov.

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Some nations are far smaller than certain regions of large countries. Can we treat these small countries as dimensionless economies, and regard regional policy as a nonissue?

The mainstream answer in the profession seems to be “yes.” Michael Beenstock figuratively labels this viewpoint the “New Jersey critique” (p. 25): What is the sense in applying regional economics to countries that can be fitted into New Jersey? The editors’ main aim is to convince readers that spatial disparities do matter. Clearly the first and most obvious question that arises is, what actually is a “small country”?

Probably everybody would agree the cases that get special attention in this book (Belgium, Finland, Ireland, Netherlands, Slovenia, Israel, Switzerland, and Austria) qualify as such. But finding a coherent definition is difficult, as Felsenstein and Portnov point out in their introductory chapter. Population, surface, and total national income seem to be possible categories, complemented perhaps by the degree of economic openness.

Finland is small in terms of population, but clearly not in terms of territory. In terms of GDP, almost any African or former Soviet state must be regarded as “small.” And what about microcountries such as Luxemburg or Malta? Aren’t they truly small according to any definition? So why are they not covered in this book?

The editors make a wise choice to focus on developed countries that are well integrated into and heavily dependent on international trade. They also require a country to have several meaningful administrative or economic subunits, leaving aside tiny city-states. That may seem like an implicit acceptance of the “New Jersey critique,” because none of the contemplated cases could actually be fitted into New Jersey. Sensible economists would probably not deny a priori the importance of disparities in countries the size of Belgium or Switzerland, but some simple intuition would suggest regional problems are less severe compared to, say, in Germany, France, or Spain.

In Chapter 2, Felsenstein and Portnov deal with the rationale for this expectation and essentially argue that it may be wrong. They present an exhaustive collection of arguments and counterarguments on the impact of “smallness” on the degree of spatial disparities. Climatic and geographical conditions are less likely to vary across regions, commuting is easier, the population is more likely to be homogenous, and access to policy makers is more direct. All of this seems to support the conventional wisdom that small countries will exhibit less internal differences. However, each of these arguments can also be turned upside down. The most appealing reasoning to me is that small countries are more likely to be monocentric. To exploit scale economies in the production of certain goods and services, many of them are dominated by a single metropolis that attracts a lion’s share of the country’s production factors. Capital cities such as Budapest or Sofia throw a long “urban shadow” over their hinterlands, and thereby tend to exacerbate disparities. Furthermore, the Swiss experience suggests that even the tiny cantons can create very diverse institutional arrangements that can potentially increase real economic differences. Hence, there is no reason to believe there will be an unambiguous negative relation between country size and regional disparities.

Michael Beenstock adopts a more formal approach, and asks if economic theory makes any clear predictions. He starts by considering two independent countries A and B between which capital can move freely. Labor is initially immobile, and the countries have an identical ability distribution across workers. This gives rise to an initial level of intra- and interregional earnings disparities. How does economic integration of the two countries, that is, the introduction of perfect labor mobility, affect inequalities? Using Roy’s selection model and extensions thereof, Beenstock shows that integration increases average wages, but in general nothing can be said about how earnings disparities within or across regions will change. Economic disparities in the integrated country (A + B) need not be larger than in either one alone. Moving to macroeconomic considerations, Beenstock summarizes that one cannot expect real income per capita or growth to depend positively on country size, because evidence overwhelmingly rejects scale effects in endogenous growth models (pp. 34–35). He also suggests growth need not be more volatile in small countries. Even if large countries tend to have a better-diversified industrial structure, he postulates (yet without presenting the basic evidence) that in practice diversification is sufficient in small countries, so that volatility and exposure to asymmetric shocks is not notably different.

In my view, Beenstock’s competent theoretical analysis is a core chapter of this book. It is comprehensive in combining statistical, micro-, and macroeconomic perspectives, but at the same time inevitably is constrained not to address too many issues. Perhaps the book should have had additional theoretically oriented chapters. For example, a perspective from urban economics might have been useful, that is, an attempt to formalize why small countries are often monocentric and what follows from that. The major part of the book consists of empirical case studies of regional disparities in several small countries. The methodologies used in these studies are quite heterodox, encompassing purely descriptive overviews, econometric attempts to disentangle the sources of disparities, and visualization techniques more common in geography than in economics. An interesting parallel is the use of econometric analogues of the traditional deterministic shift-share method (e.g., by Olivier Meunier and

Michel Mignolet on Belgium and by Eoin O'Leary on Ireland), which suggests that this methodology might potentially become something like a "workhorse model" for regional analysis. The basic result of the case studies perhaps can be summarized: Each of the small countries exhibited quite substantial regional differences in economic activity, which did not vanish over time.

The chapter by Jos'e Corpataux and Olivier Crevoisier on the evolution of differences in Switzerland is particularly noteworthy. This essentially nontechnical paper is so neat, because it offers a very appealing story that links economic geography with international monetary economics—something that is very rarely done in the literature! The Swiss economy is divided between financial metropolises (mainly Zurich and Geneva) and the rest of the country. Between 1975 and 1995, Switzerland's financial sector developed rapidly to become a worldwide center for private transborder asset management and headquarters services for multinational enterprises. The resulting huge inflow of capital was associated with a considerable appreciation of the Swiss franc, which in turn affected the traditional Swiss export industries (watchmaking, textiles) adversely on the export front. The only way for the export industries to react was to increase productivity by specializing in high-end niche products. This led to considerable job losses in manufacturing, and—on a spatial level—to increasing divides between the financial cities and the regions specialized in industrial mass production (like Eastern Switzerland).

Negative repercussions of the currency appreciation were particularly harmful for the tourism regions. Corpataux and Crevoisier emphasize that not only the traditional agglomeration forces but also monetary phenomena can have a deep impact on structural change and economic geography.

However, a collection of single-country studies is only partly useful for addressing the main concern of the book: Is there a difference between small and large economies? A chapter by George Petrakos, Yiannis Psycharis, and Dimitris Kallioras finally adopts a multicountry perspective and addresses precisely this question. The authors look at disparities in the ten EU accession countries. Using traditional indicators and the concept of σ -convergence, they notice a tendency for disparities to widen in virtually all accession countries over the period 1995–2000. There is no clear pattern of divergence being stronger in large countries such as Poland, or small ones such as the Baltic states. When they group countries by size, they find that divergence is significant only in large countries, but also that the level of disparities (measured by the coefficient of variation of regional GDP per capita) is almost equally large in small countries, which seems to be driven mainly by the presence of one dominating metropolitan area. In sum, Petrakos, Psycharis, and Kallioras present somewhat mixed evidence on the relationship between country size and regional disparities, but they show clearly that disparities are not at all meaningless in countries of Estonia's or Slovenia's size. Again one may argue that more space should have been devoted to such multicountry empirical work (probably at the expense of one or two single-country case studies), in order to present robustness checks and to develop more definite conclusions.

The only other essay that adopts a comparable multicountry perspective is one by Carlos Gil, Pedro Pascual, and Manuel Rap' un, who investigate the relationship between fiscal decentralization and regional disparities. Theory is ambiguous on this point: A centralized state may exhibit less internal differences, because the government can more easily pursue active redistributive policies. On the other hand, the interests of policy makers from the central government may be biased toward particular regions like the capital, leading to a neglect of peripheral areas. Using data from OECD countries, Gil, Pascual, and Rap' un find in fact a negative correlation between standard indices of fiscal decentralization and regional disparities in GDP per capita. Hence, according to them decentralized states exhibit less internal disparities in real economic activity than centralized ones, and this conclusion holds similarly (or even with greater confidence) for the subsample of small countries. These are surely interesting and challenging results, whose robustness, however, should be checked in future research, as the authors base their results on a pure cross-section analysis of a rather small sample.

All in all, the book stands out from many other edited volumes by being clearly focused on one particular topic, rather than being a collection of loosely related individual papers. This makes for an exciting and inspiring reading for geographical economists. Small countries—in the definition of Felsenstein and Portnov—do not appear to be much different from large countries when it comes to regional disparities.

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