For a volume in memory of Jóannes Jacobsen
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Extra small countries can flourish

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Is Iceland too small? Are there too few of us? Does it take a critical mass of people for a country to be able to prosper in the long run? If so, what is that critical mass?

On these pages I want to present some anecdotal as well as empirical evidence in support of my answers to those four questions and they are: No, No, Yes, and Ca. 50K. If so, neither Iceland nor the Faroe Islands are too small to stand on their own feet in the community of nations. Extra small countries can flourish and often do. Examples abound. His work with Stefan i Skorini, *Á veg móti einum sjálfberandi búskapi* (2010), tells me that Jóannes Jacobsen would almost surely not have been surprised.

Large countries and small

It is a widely held view that Iceland is larger than it is. On maps, Iceland often appears nearly as large as Spain even if Spain is five times larger than Iceland by area, and Greenland appears to be almost as large as the African continent *in toto* even if Greenland is actually smaller than Sudan — yes, Sudan! This is, as you know, because many world maps exaggerate the size of countries close to the Arctic, or the South Pole for that matter.

Iceland is, in fact, a mid-sized country by area. Of the world's roughly 200 states, about 100 are smaller than Iceland, and the other 100 are larger. Measured by population, however, Iceland is definitely an extra small country, though not tiny. There are about 40 countries with fewer inhabitants than Iceland, a sizable group.

The number of sovereign states has risen dramatically since 1946, from 76 to 195, the current number of member states in the United Nations. When colonialism began its retreat before 1950, the number of independent states was bound to rise. In Africa alone, from 1960 to 1964, 25 new states came into being. The collapse of communism increased the number of sovereign states in Eastern Europe by ten and West Asia by six.

[1] I thank Eidur Bjarnason, Lars Jonung, Thorkell Helgason, Thórólfur Matthíasson, Hermann Oskarsson, Robert Wade, and Gylfi Zoega for helpful comments on earlier versions of the text.

Nearly a half of the world's countries are smaller – i.e., have fewer people – than Denmark with its 5.9 million people. The world is increasingly comprised of small states. The European Union has become a union of small states, which prosper through their joint access to a large common market as well as through their mandated adoption of common laws and regulations intended to promote good governance.

Knut Wicksell, the great Swedish economist (1851-1926), was perhaps the first economist to talk about the "optimal size of the population of a country," from a neo-Malthusian perspective. He traced many of Sweden´s economic ills to too many people, arguing that Sweden's optimal population size, which during his lifetime had grown from 3.5 million to six million, was around three million (Wicksell, 1926).

"The dearth of people is Iceland's greatest social curse," said national poet Einar Benediktsson (1864-1940) around the turn of the 20th century. He and others suggested that Iceland import foreign labor to enlarge the country. They saw no way to offer Icelanders an acceptable and decent standard of life in the long run except by attracting enough immigrants from abroad to reach a critical mass, estimated to lie well above 100,000, a population figure not reached in Iceland until 1926, far below Wicksell´s optimum.

Ancient Athens had 200,000 inhabitants and fared well. Venice and Florence flourished in the Middle Ages with 115,000 inhabitants and 70,000 inhabitants, but both cities were well placed and did not face the long distances from their neighbors and high transport costs that Iceland did. They could afford being small. They were able to recompense for their lack of people through extensive trade with other cities and regions. By contrast, Iceland needed more people to compensate for the inconvenience and inefficiency of small scale and scope and the long trade routes to other countries.

Introverts against extroverts

At the time of those debates, many people – you can call them introverts, or preservationists – opposed immigration on the grounds that, on a grand scale, it would threaten Iceland's national identity, language, and culture. They had not forgotten that, in the 18th century, the ancient language of the Icelanders had come close to disappearing like the Prussian language had perished. Later, the Irish language was close to going under as well, but it barely survived and remains an official language of

Ireland, spoken by about 2% of the country's population. Be that as it may, Icelandic, though under stress, is still going strong. Meanwhile, the introverts seemed to have forgotten that during 1870-1914 a fifth, some say a quarter, of Iceland's population had emigrated to North America, where they had been welcomed with open arms.

The extroverts saw things differently. They saw an increase in the number of speakers of Icelandic by thousands or even tens of thousands as a probable boost to our national consciousness, ambitions, and culture. In essence, they saw national dignity and foreign workers as a false contrast.

The introverts won the debate. They went on to use their antipathy toward immigration as an argument against Iceland's accession to the European Union in the early 1990s. They won again in that Iceland, unlike Finland, Norway, and Sweden, did not hold a referendum on EU membership in 1994 even though – or perhaps because – opinion polls showed a majority of the electorate in favor of entry. Even so, in 1995, Iceland joined the European Economic Area, which changed the landscape completely by making Iceland part of a European common market for labor and by thus relieving long-standing wage pressures in local labor markets, which helped to reduce inflation. The change was rapid. In 2019, 18% of Iceland's inhabitants were born abroad, up from 5% in 2000 and 2% in the 1960s. For comparison, in 2019, 10% of Denmark's inhabitants were foreign-born, 14% in the United States and Great Britain, 16% in Norway, and 20% in Sweden (source: OECD).

Tourism, which attracts many foreign workers, has become Iceland's most important earner of foreign exchange, earning more foreign currency each year (26% of the total in 2022) than either the fisheries (24%) or the aluminum industry (21%). The front lines of the debate on immigration have moved now that foreign workers make such an important contribution to Iceland's economy, not only to tourism but also to the fisheries and even aluminum. As before, extroverts look beyond Iceland's shores and further ahead, they welcome the new multicultural aspects of Icelandic society, and want Iceland to grow larger. Introverts look inward and backward in time with nostalgia and want to be on guard against foreign influences: they want Iceland to remain an extra small country with a homogeneous population.

The extroverts see a false contrast in all this, as they think that Iceland's enlargement does not need to compromise our national identity. They ask: Has EU membership eroded the national identity of any current member country? Are Danes less Danish than they used to be? The answer is No (Gíslason, 1984).

Too small?

There are benefits as well as costs associated with small size (Alesina and Spolaore, 2003). Plato and Aristotle, the Greek philosophers, emphasized the benefits. Plato argued that the correct number of households in each country was 5,040 (this is not a misprint). If the typical household counts ten people (children, old people, slaves, and others), that puts the optimal number of people per country at about 50,000. Plato wanted a population no greater than the country could bear. Aristotle believed that each country would have to be small enough to be governable and also large enough to be able to sustain itself.

Small countries are generally more cohesive than large ones and thus have more effective control over their affairs without being distracted by the animosity and fragmentation that characterizes some large countries, though not Japan. With fewer taxpayers to foot the bill for public services and to cover fixed costs, small countries need to compensate for the disadvantages of their size through judicious governance, including economic management, but their larger neighbors often find it to be in their own interest to cover certain fixed costs, for example owing to national defence (think Iceland and NATO, the Faroe Islands and Denmark).

Spence *et. al.* (2008) make this point succinctly:

"The world economy is dotted with a large number of very small states, where the per capita cost of government and public services is inevitably high. Because of their small size, they have little scope to diversify their economies, which leaves them highly vulnerable to external shocks. The answers lie in embracing the world economy, forming regional clubs, and outsourcing some government functions."

Some observers blame Iceland's small size for the banking collapse in 2008 as well as for its long history of high inflation and other economic ills and question the ability of the Icelanders to stand on their own feet as a free and sovereign state and to run a prosperous and healthy society. They claim that extra small countries are bound to suffer from a lack of a competent labor force and a critical mass, sometimes adding that very small countries cannot produce people like Mozart.

But Mozart's birthplace, Salzburg, did not reach the alleged critical mass of 100,000 inhabitants until the 1950s – 200 years after he was born! Here, Mozart is a strawman. Geniuses like him add color to life, true, but they are not essential. People are generally the same everywhere, whether in small countries or large. The sole significant difference is that some countries take better care of their people than others. This is a matter of economic and social development rather than population size. The raw material is the same everywhere. Geography and history also matter.

The skeptics sometimes make the further point that extra small countries where everyone knows everyone else are prone to oligarchy, insider dealing, clientelism, nepotism, and other forms of corruption as well as impunity under the protection of complicit prosecutors and judges. Moreover, governments in extra small countries may find it easier to rein in the media. But wait: The fact that everyone knows practically everyone else, and what they are up to, should, on the contrary, make it easier, not harder, to keep corruption in its various guises under control. Pervasive corruption in India, China, Indonesia, Pakistan, Brazil, Nigeria, Bangladesh, Russia, and Mexico, to name nine of the world's eleven most populous countries ordered by size, cannot be blamed on their being small. More likely, their lack of democracy may be partly to blame; their most recent average score for political rights and civil liberties assigned by Freedom House is 45 out of 100, from 9 in China to 73 in Brazil.

In addition to the obvious disadvantages of extra small size (fewer taxpayers behind the National Symphony, etc.),[2] what some of the skeptics in Iceland also have in mind is a culture of complicity, which they trace to very small size. One example will do.

At the time of the financial crash of 2008, the Central Bank of Iceland continued to the bitter end to throw good money after bad, even two years after senior bank officials, according to their own sworn testimonies before the Parliament's Special Investigation Committee in 2010, realized in 2006 that the commercial banks were, in essence, Ponzi schemes, bound to collapse. All the same, in September 2008, the Central Bank lent Kaupthing Bank the rest of its foreign exchange reserves, 500 million euro. "There was no ... written bank board resolution on the loan," the Central Bank itself has declared. As a matter of public record, a third of the "loan" was transferred directly to Tortola.

Not one of those Central Bank officials, who bore witness before the Special Investigation Committee in 2010, spoke up until after the crash. Why? Perhaps because they had nowhere else to go. Perhaps they feared what the Germans call *Berufsverbot*:

[2] An unnamed friend of mine keeps a long list. One drawback of small size, he says, is that you keep running into old lovers. I tell him: The same is true of Manhattan, just ask Woody Allen.

losing their jobs with nowhere else to find work at home. True, such a work ban is probably easier to enforce in a small country than a large one. Clearly, Germany, then as now a large country, was able to impose *Berufsverbot* against the supposed enemies of the state in the 1930s. Dictatorships can be either large or small.[3]

Compare this with the situation in Lyndon B. Johnson's White House in the mid-to-late 1960s when several of his senior officials resigned from their positions in protest against the war in Vietnam, leading the President ultimately not to seek reelection in 1968. The White House officials could do this because they had other places to go, other employers to turn to. But is this a matter of size? Hardly. Think Russia where a comparable drama is playing out in the Kremlin as I write this. Those Russian officials who choose to resign in protest against the war in Ukraine have nowhere else to go except abroad, or worse, and this is not because Russia is small but rather because it is autocratic.

From these arguments on both sides, we can see that we need to ask: Which are more important, the advantages or disadvantages of small size? What do the data say?

Centrifugal vs. centripetal forces

But this first. Why is Europe not one country?

People are different and have different ideas, wishes, and needs. That is why the countries of the world are so numerous and different in size. The demand for improved living standards driven by cost-effective large-scale operations calls for mergers and acquisitions. The pursuit of communion with one's own people, folks who share the same culture and history and speak the same language, stands against the demands of big business. It is not good enough to have countries that are too large and too few, because large countries, other than Japan, are usually inhabited by heterogenous populations, and their great diversity can lead to fragmentation and thus thwart the people's prosperity and progress. Different groups want different kinds of public expenditure, different social services, different taxation, and so on. Yet the heterogeneity of the population of the United States has not harmed average living standards there, and the same applies to China. Extra small states can flourish if their small size is accompanied by harmony and cohesion. Small nations do not have

[3] Freedom House assigns Azerbaijan (pop. 9 million) and China (pop. 1,4 billion) the same score of 9 out of 100 for political rights and civil liberties.

to be homogeneous, however. Mauritius and Singapore are examples of small nations with people of different races living harmoniously together. Small nations are not always harmonious and cohesive either; for instance, my Icelandic tribe can be quite quarrelsome.

Experience shows that small and even extra small nations can fare just as well as large nations, and sometimes better, provided that the small countries compensate for the disadvantage of their small size through extensive trade with other countries. Centripetal forces pull countries toward further cooperation and unification, thus contributing to a reduction of the number of countries for economic reasons. Centrifugal forces, on the other hand, tend to divide countries into smaller units, thereby contributing to an increase in the number of countries, also for economic reasons. Centripetal forces had the upper hand in Europe in the second half of the 19th century. Italy became a single nation state in 1861 with the unification of several small states, and Germany followed suit in 1871. At that time, some people thought that Belgium and Portugal were too small to stand on their own feet. In the 20th century, the tables were turned, and centrifugal forces gained the upper hand with increased international trade, which enabled small countries to compensate for their lack of human resources through extensive trade with other countries, especially their neighbors. Iceland was granted home rule in 1904, became a sovereign state in 1918, and declared full independence in 1944.

Many extra small nations have prospered in the past, empowered by international trade. Without enough foreign trade, small states would prove to be inefficient due to their small size. Many of them would probably find it necessary to unite with larger countries for economic reasons. Expansive international trade solves the small nations' problem by enabling them to take advantage of scale economies through trade. Over time, international trade has contributed to the increase in the number of independent small states. The share of foreign trade in world output rose from 25% in 1970 to 57% in 2021. The average population of the six founding member states of the EU was 40 million in 1960. The average population of the 27 current EU member states is 17 million. For comparison, in 2022, the average population of the 217 countries reporting to the World Bank was 37 million (24 million if India and China are not included).

Icelanders made the right decision on full independence in 1944, even if the timing was not ideal, because Nazi-occupied Denmark was unable to fend for itself. No economic adversity will ever throw doubt on the wisdom of Iceland's decision. The dearth of people does not necessarily stand in the way of successful sovereignty, rapid economic growth, and widely shared prosperity with good governance, even if it can be argued, as Einar Benediktsson did, that a larger population would lift the country. Many of those who favor Iceland´s accession to the EU see it as a step toward Iceland's enlargement.

At the time of independence in 1944, Iceland's population was 126,000. Income per person was only a fraction of what it is now, but that does not really matter. Low incomes cannot in general be held forth as a legitimate reason against declaring independence. Countries declare independence for much the same reason as young people, who happily leave the homes of their parents to establish new homes of their own, the ultimate everyday form of declaration of independence. The transition to independence may be costly, true, but such expenses were not an issue in Iceland in 1904 or 1918 and least of all in 1944, because the "blessed war" as some Icelanders referred to the Second World War created an economic upswing in Iceland. BREXIT is different in that it has proved quite costly to the people of Britain.

With increased international trade, small nations have gained strength in recent years. Without foreign trade, small states could not achieve sufficient efficiency due to their less-than-ideal size. Therefore, many of them would probably find it necessary to unite with larger countries for economic reasons. Extensive trade relieves small nations of this need by enabling them to exploit economies of scale and scope through trade with other countries.

Continued trade with the rest of Europe is one of the keys to the demand for independence for Catalonia and Scotland from Spain and the United Kingdom, with continued or restored membership of the EU. From this you can tell how outlandish the Scots with their 5.2 million inhabitants, just a touch below Denmark and Norway, and the Catalans with their 5.8 million, find hearing London and Madrid claim that Scotland and Catalonia are too small to be independent.

The banks in Barbados

I am not changing the subject, but I was in Calgary at the foot of the Rocky Mountains, on the Canadian side, at the invitation of locals of Icelandic stock to give a lecture about Iceland and the 2008 financial collapse. This was in 2009.

During the lecture in Calgary, I felt the need to explain to my audience that Iceland's small size did not strike me as a likely cause of the collapse. I understood that it would not be a good idea to take Iceland as an example of "Small is beautiful," as I had sometimes done on similar occasions before. As I spoke, the International Monetary Fund was in the middle of an emergency rescue operation in Iceland, co-financed by taxpayers in the Nordic countries, Poland, and the Faroe Islands. The banks had, criminally as it turned out according to the report of the Special Investigation Committee and several Supreme Court verdicts, caused their creditors, shareholders, and customers the greatest financial harm on record relative to the size of the country. Praise for Iceland would, therefore, not have fallen on fertile soil on this occasion; my audience would have stopped listening. Therefore, I took the example of another country with 300,000 inhabitants, Barbados, a sovereign island nation in the Eastern Caribbean. I had been there twice.

Suffice it to say, Barbados had done quite well despite its small population. The country had been a British colony for more than 300 years and achieved its independence in 1966. Most of its inhabitants are descendants of African slaves, who were brought there to work on British sugar plantations. Sugar exports were for a long time the backbone of the country's economy, but the sun sailed past sugar shortly after independence. Tourism has ever since been the mainstay of the islanders. Living standards improved by leaps and bounds, well ahead of those of Mauritius (pop. 1.3 million), another island in the sun where sugar exports had given way to foreign tourists. Not only that: the people of Barbados live almost as long on average as the British, 78 years in Barbados compared with 81 years in the United Kingdom, the mother country.

Barbados has a solid infrastructure inherited from the British: unfettered democracy, free press, uncorrupted judiciary, no nonsense. In 2023, Freedom House granted Barbados a higher democracy score of 95 than the British score of 93. The Barbadian government has followed sound economic policies for decades, keeping inflation low and poverty low as well. The islanders have managed to keep the Barbadian dollar exchange rate fixed since 1975 at two Barbadian dollars to one US dollar, enabling them to decline the invitation of the people of the surrounding islands to join their currency union and adopt the East Caribbean Dollar, whose 100 dollar bill with Queen Elizabeth on the front and Sir Arthur Lewis, the development economist, on the back, with Adam

Smith the sole other economist to be so honored. Nations in firm control of their monies have no need to share their currency with others.

As I finished my song and dance about the beauty of smallness in Barbados, a silver-haired lady at the back of the auditorium raised her hand and said, “Professor, it seems to me that you may have overlooked an important point.” My heart skipped a beat. The woman continued, “The banks in Barbados have always been Canadian.”

She was right. I had overlooked this important point.

Ever since I have recounted the story of Barbados with this important addition about the banks. Canada does indeed have a sound banking system, strictly supervised. Not only did the financial crisis of 2007-2008 pass Canada by, but so did also the Great Depression of 1929-1939. A few small banks failed; that was all.

Barbados grew rapidly from 1990 to 2008 but stagnated thereafter, struggling like many other countries to recover from the global financial crisis. Meanwhile, Mauritius, having risen from modest beginnings to its modern African superstar status through farsighted macroeconomic policies coupled with financial discipline, continued to grow as before (Frankel, 2014). The purchasing power of per capita income in Barbados was 90% higher than in Mauritius in 1990 and 60% lower in 2022. Mauritius has a good banking system with local as well as foreign banks. Both countries have prospered partly because they are rock-solid democracies.

Earlier attempt

A quarter of a century ago, intrigued by the arguments and anecdotal evidence described above, I subjected the Critical Mass Hypothesis – the hypothesis that extra small nations tend to fare less well than larger ones – to some formal statistical tests. I did this by comparing the economies of 26 island states with populations ranging from 100,000 to 1.3 million with the world as a whole, a control group comprising all 207 countries then reporting to the World Bank. I described the results in several lectures, including presentations at the European Commission in Brussels as well as at an international conference at Harvard University, and one short article (Gylfason, 2009).

I found that my sample of extra small island states proved to have a 40% higher per capita national income on average in 1999 as well as an average life expectancy that was six years longer than in the world as a whole, while the per capita income growth rates of the two groups from 1960 to 1999 were indistinguishable. The data showed, furthermore, that during 1960-1999 the extra small countries in the sample were typically more open to foreign trade and investment than other countries, sent more youngsters from each cohort to secondary school, and spent more public money on education and invested more in machinery and equipment in proportion to national income. The results were statistically significant for the most part. They struck me as reasonable because trade, education, and investment are important pillars of economic growth.

These results seemed consistent with the idea that extra small countries need to make up for some of the drawbacks of their small size, such as limited possibilities for economic diversification, through extensive trade with other countries. The results differed from those of Armstrong *et al*. (1998), who reported that "The set of world micro-states, defined as those [105 states] with population under three million, exhibits virtually as wide a range of GDP and GNP per capita values as the full set of world countries."

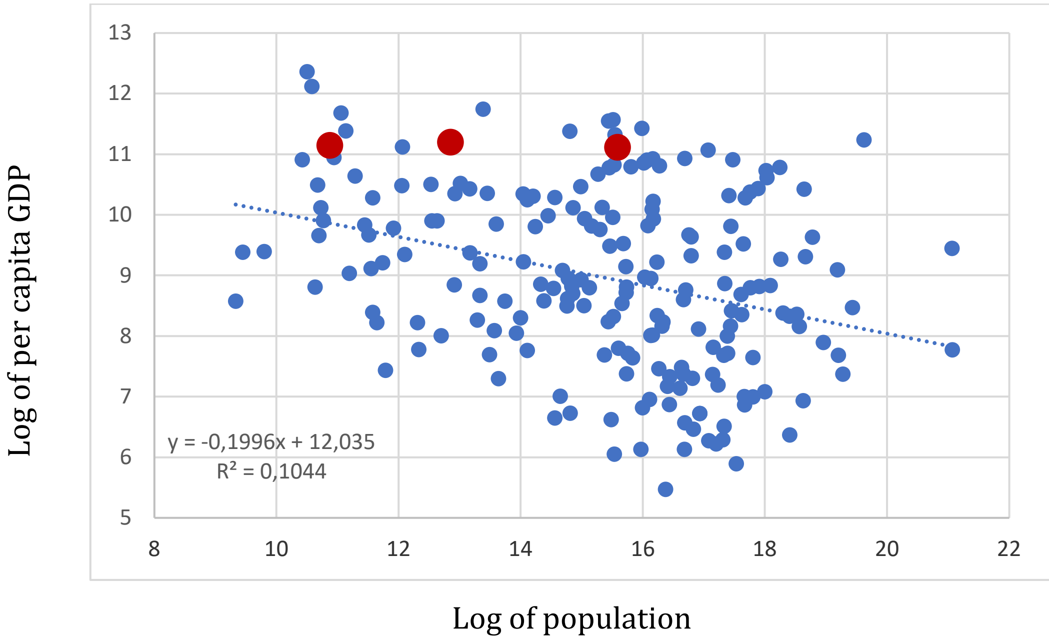
Among other findings of my early attempt were that during 1960-1999 the extra small countries had higher public expenditures and lower military expenditures on average relative to national income than the world as a whole, which accords with the idea that public services cost more to provide in small countries and that small islands cost less to defend, especially if they have generous friends and neighbors. I also found that the extra small countries had a larger share of agriculture in national output and a lower share of manufactures and high-tech items in total exports on average than the world as a whole, the sole result suggesting that small size need not be uniformly good for growth.

New data, wider vistas

Now the time has come for me to report the results of my return to the Critical Mass Hypothesis with new data and new variables inspired by the modern theory of economic growth, which was in its infancy in the earlier round 25 years ago, to see if my earlier findings have stood the test of time.

Let me set the stage by first showing a scatterplot of population and per capita GDP in current US dollars in the 204 countries, large and small, which reported both statistics to the World Bank for 2022. Chart 1 displays natural logs on both axes. What you see is a downward-sloping regression line through the scatterplot with a significantly negative slope of -0.20 (t = 4.9). Taken at face value, the plot suggests that a doubling of the average country's population goes hand in hand with a 20% decrease in its per capita GDP as a local approximation. More importantly, perhaps, the chart shows that extra small countries are not doomed to hardship. The bottom left section of the chart is sparsely populated. The three countries represented by the enlarged dots are, from left to right, the Faroe Islands, Iceland, and Denmark.

Chart 1. Per capita GDP and population in 204 countries, 2022

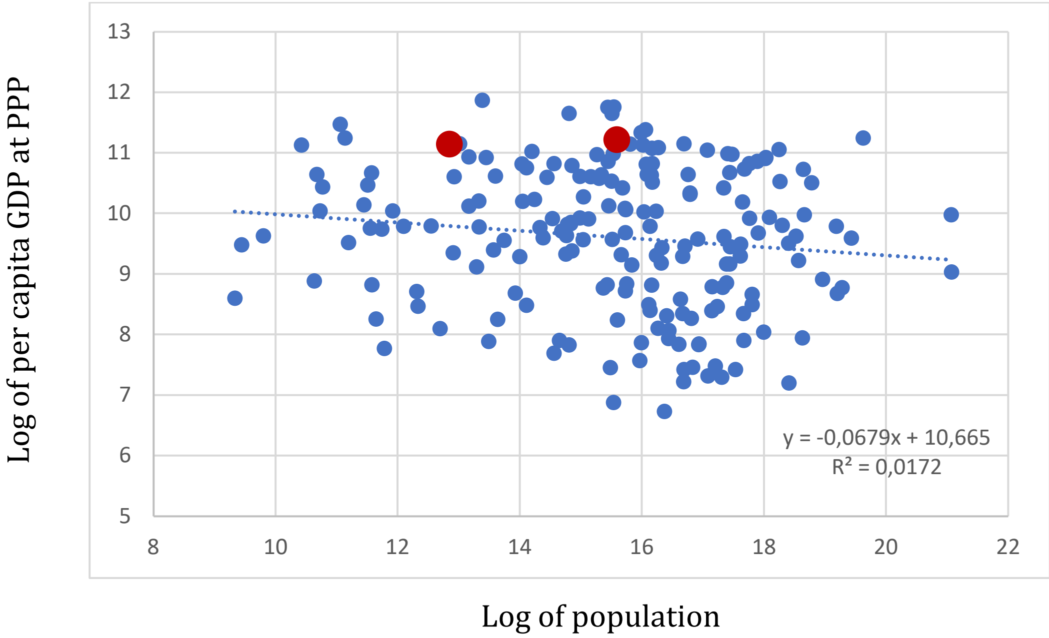


Source: Author´s computation based on data from World Bank, *World Development Report* 2023.

The GDP figures in Chart 1 show GDP, not its purchasing power. The conversion of the GDP figures by the World Bank's purchasing power parity (PPP) conversion factor reduces the sample size by 11, from 204 countries to 193, because PPP-adjusted GDP figures are not available for those 11 countries, including six of the extra small countries under review here.

Chart 2 shows the scatterplot of population and the purchasing power of per capita GDP in current international dollars in the 193 countries for which we have data. The sole difference between the two charts is that Chart 2 describes fewer countries because we now have PPP-adjusted per capita GDP figures on the vertical axis in Chart 2, not unadjusted per capita GDP as in Chart 1. We still see a downward-sloping regression line through the scatterplot, but now one with a much smaller and only marginally significant negative slope of -0.07 (t = 1.8) compared with Chart 1. The discrepancy between the two charts is perhaps understandable in view of the fact that six of the 11 countries, 5% of the larger sample in Chart 1, that needed to be removed for lack of data belong to the group of extra small countries, to which we now return.

Chart 2. Per capita GDP at PPP and population in 193 countries, 2022



Source: Author´s computation based on data from World Bank, *World Development Report* 2023.

Let me now focus on a sample of 33 small island states with a population from 50,000 – Plato's number! – to one million and compare them with the world as a whole, now the 217 countries reporting to the World Bank.

This means that the Faroe Islands and Greenland are now included in the sample, but they were not included in the earlier round because the lower limit on population was then set at 100,000, nor could they be included in Chart 2. As before, only extra small island states are considered.[4] This means that land-locked states in the same size category are not included. Some of these smaller countries are sovereign states, but most are not. All have significant autonomy.

[4] The 33 countries are Antigua and Barbuda, Aruba, The Bahamas, Barbados, Bermuda, Cabo Verde, Cayman Islands, Channel Islands, Comoros, Curacao, Dominica, Faroe Islands, Fiji, French Polynesia, Greenland, Grenada, Guam, Iceland, Isle of Man, Kiribati, Maldives, Malta, Micronesia, New Caledonia, Samoa, Sao Tome and Principe, Seychelles, Solomon Islands, St. Lucia, St. Vincent and the Grenadines, Tonga, Vanuatu, and Virgin Islands (U.S.). Cyprus and Mauritius were included in the earlier round, but are not included here because their population exceeds one million.

The question of the economic and social development of small countries is an important one. If the evidence indicates that extra small countries have fared less well than larger ones, should they then perhaps think twice before claiming independence?

I have already answered that question with an unequivocal No, on the grounds that all countries, rich and poor alike, aspire to freedom and independence the same way as young people who declare their indpendence by leaving their childhood homes to establish families of their own, as a rule independently of their economic status. If extra small countries turn out to have fared less well than larger ones, then a more appropriate response, as I see it, would be for them to want to grow larger as Einar Benediktsson proposed in Iceland in his day, but that is another story.

Table 1 summarizes the main results of the comparison.

Table 1. Status of 33 extra small island states

	GDP per capita 2021 (USD)	Life expectancy 2021 (years)	Exports of goods and services 2021 (% of GDP)	Secondary school enrolment 2000-2018 (% of cohort)	Investment 2021 (% of GDP)	Agriculture, forestry, and fishing 2021 (% of GDP)	Internet use 2021 (% of population)
33 small countries	22,857*	74.7*	37.9	69.9	26.2	2.2*	73.1*
World	12,237	71.3	28.9	61.3	26.9	4.3	63.1

Source: Author's computations based on data from World Bank, *World Development Report* 2023. Note: An asterisk denotes a statistically significant difference from the world average. The school enrolment variable is only marginally insignificant with z = 1.93. For exports, z = 1.33. The sample size of 33 dictates the use of z tests rather than t tests, which are approriate for smaller samples in nonparametric comparisons.

Higher incomes, longer lives

The average income per capita of the extra small countries in the sample is now almost 90% higher than the world average. The extra small countries have increased their lead from the earlier round, where the difference was 40% in their favor. These income figures reflect output produced, not its purchasing power, because purchasing power adjustment for six of the the extra small countries is not available.[5]

Economic statistics need to be complemented by relevant social statistics, which sometimes give a better view of the goings on. The inhabitants of the extra small

[5] In the earlier round, the per capita income figures were adjusted for purchasing power; the data were available at that time.

countries in our sample enjoy not only higher incomes but also lead longer lives: they live more than three years longer on average than the world population as a whole. The life expectency gap has contracted since the earlier round, however, as most of the world has experienced a significant increase in life expectancy at birth.

The extra small countries are more open to foreign trade than other countries usually are, that is, their exports of goods and services make up a higher proportion of output than in the world as a whole. Unsurprisingly, this shows that extra small countries use foreign trade to compensate for the drawbacks associated with their small size.

The comparison also shows that small countries send a higher proportion of each age group of young people to secondary school than is customary in the world at large. This also strengthens the position of the small countries. On the other hand, investment in the extra small countries is not any higher than elsewhere.

In sum, the extra small countries have the upper hand in foreign trade and education, but not in investment.

The extra small countries have generally managed more successfully than other countries to adopt a modern way of life. They have done more to scale back the share of agriculture in their economies to make way for industry, trade, and services that are typically more conducive to economic growth than agriculture and they have also done more to embrace modern computer technology and the internet.

Democracy, transparency, rule of law, and equality

Table 2 indicates that democracy is stronger in the extra small countries in our sample on average than in the world as a whole. Freedom House covers 21 of the 33 extra small countries under review, and their average democracy score is 80.7 out of 100 compared with 59.3 for the world at large, 195 countries. The liberal democracy scores from the Institute for Democracy at the University of Gothenburg accord with those from Freedom House. The average democracy score of the eleven extra small countries covered by the data from Gothenburg is 0.53 compared with 0.40 for the world as a whole, 178 countries. The liberal democracy index spans the range from zero (dictatorship) countries to one in (democracy). The extra small countries do better.

Table 2. Democracy in 33 extra small island states

	Freedom House (21 countries)	Gothenburg (11 countries)

33 small countries	80.7*	0.53*
World	59.3	0.40

Source: Author's computations based on data from Freedom House and Gothenburg University.
Note: An asterisk denotes a statistically significant difference from the world average.

How about corruption? Transparency International ranks 180 countries based on perceived corruption. The data from Transparency cover only 16 of the 33 extra small countries under review. Of those, 15 countries are less corrupt than the world average in the sense that their transparency ranking is 90th or higher; the sole exception is Comoros (167th).

Under the auspices of the American Bar Association, the World Justice Project issues its annual ratings of the rule of law around the world, now in 126 countries, including eight small island states among the 33 under review. In those eight extra small countries, the average score is 6.2, compared with an average of 5.5 for all 126 countries in the sample. Once more, the extra small countries do better.

Available data on income distribution are incomplete, but they have improved and now cover, with various gaps, 15 of the 33 extra small countries in our sample and 161 countries out of the total of 217 during 2000-2021. The average of the Gini index of inequality in the distribution of income in those 15 extra small countries is 38.5 during this 21-year period, the same value as the average for all 161countries. For comparison, the average Gini indices of Denmark, France, and the United States are 26.9, 32.0, and 40.8 over the same period. This indicates that the extra small island states are no paragons of equality.

These findings on democracy, transparency, justice, and equality can be broadly viewed as good news for extra small countries because all four are most probably good for long-run economic growth. These indicators could not be included in the earlier comparisons 25 years ago, because the requisite data were not yet obtainable. Even today, available data on trust in institutions as well as interpersonal trust do not cover any of the extra small countries under review here, with the sole exception of Iceland. At present, therefore, nothing can be said about trust in extra small countries compared with the rest of the world. This matters because trust is an essential ingredient of social cohesion, which is good for growth.

Open doors and windows

The costs and benefits of the size of nations are important.

Polls suggest that opinions are still divided among the Faroese people as to whether time has come for them to take the step that the Icelanders took in 1944, when we founded our republic and declared full independence from Denmark. The Faroese population is smaller now than Iceland's population was then. Extra small size has certain disadvantages, true, as I have discussed here, but there are well-known ways to overcome those drawbacks through good relations and expansive trade with other countries, with open doors and windows. The results I have reported here suggest to me that the Faroese do not need to fear full independence, provided they make every effort to manage their affairs judiciously. To repeat, nations usually decide to declare independence mainly for social and cultural reasons as well as for reasons of history and geography rather than for narrow economic reasons, much like young people who happily move away from home.

Even if the comparisons presented here and before had led to the conclusion that the drawbacks of extra small size outweigh the advantages, holding back the prosperity and prospects of the people, most Icelanders would never even consider the possibility of returning our keys to Copenhagen, no matter what. I believe that the correct response to such a result, were it to emerge from statistical analyses, would be to turn defense into offense, enlarge the country, and fortify our independence rather than forsake it.

To paraphrase Winston Churchill, the best way to strengthen a country's independence is to share it with others, for example through EU membership.

But this is hypothetical. The results presented here suggest that, fully independent or not, extra small countries can flourish and often do.

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