Size Matters: Democratization Data from Microstates

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Most datasets arbitrarily omit countries below a certain population threshold, anywhere between two million and 300,000. This may make for simpler coding, and if the goal is to capture the main trends of how the world's population lives it may be theoretically justified. However, if the goal is to shed light on the mechanisms by which democracies form and stabilize, omitting these countries censors the data and eliminates a great deal of theoretically useful variance. Theorists who have performed these censored studies have missed an important empirical regularity. The Freedom House scores, which do not omit small states, show that small states are more democratic than average, and by quite a large margin. We will revisit this result with more sophistication later on, but to keep the impatient reader interested I will note that a neanderthal-style t-test gives a significance level of $p < 0.0000002$, which in social science probably means there's something going on.

This paper has three goals. First, it seeks to establish beyond a reasonable doubt that this is a real, theoretically-distinct empirical finding and is not a reflection of the effect of an obvious confounding variable. Second, it seeks to explain this empirical result theoretically. In Rousseauean political thought the size of the polity is a theoretical primitive, but according to most modern conceptions of democratization it is not. Must we turn back to Rousseau, or can we find an aspect of smallness with more direct theoretical implications for democracy? And third, the paper seeks to leverage these theoretical results into the broader study of democratization. The 32 independent countries I define as microstates together hold less than six million persons, equivalent to perhaps 30% of Mexico City's metropolitan area population. A result about these people might be interesting the same quaint sort of way as Tuvalu stamps are fun to collect, but such a result would probably not be called important. Perhaps, however, the inclusion of this analysis within the broader field can shed further light on how democracies form and stabilize, a question which is clearly important. This is my hope.

The key difference between microstates and other countries, I argue, is that to a greater extent the governments of microstates must be able to make credible commitments in order to survive. First and most basically, kleptocratic states are unlikely to survive by leeching off accumulated resources because with a population of 475,000 or less there is just not that much to skim. A chartered jet of thugs could pacify one of these states without too much trouble, but after a week of good looting the thugs would polished off most everything worth stealing and would have to start taking civics lessons—in contrast to Congo, for example, which Mobutu managed to run into the ground for decades.

Second, when the state is transacting a large proportion of its potential transaction partners are outside its boundaries. Someone starting a business in Egypt is probably an Egyptian, and will weigh government credibility and the costs of corruption in the decision of whether to start the business or keep the cash under his mattress. In contrast, someone considering a transaction in the Bahamas is likely an outsider choosing among any number of tourist destinations, fishing licensers, trading partners, or locations for offshore finance and tax evasion. Much of what the government is selling is its reputation: it will keep tourists safe from harm, it will honor fisheries licenses and protect fish stocks, it will maintain port infrastructure so shipping investments pay off, and it will not seize financial assets in the country, or defraud, blackmail, or reveal those who use its financial system illicitly. Those buying its reputation, in turn, have a large number of other potential trading partners: unlike with the Egyptian who would have to move to found a business elsewhere, next-best tourist destinations or tax havens are of close to equal value, and the state has very little

bargaining power.

At the most basic level, this theory gets at the question of whether democratization is the result of a bottom-up process of modernization and increasing popular demands for freedom, or the result of decisions by government leaders about what constitutional form will best allow them to serve their own interests. This is a basic question for both the theory and policy of democratization. Much past evidence seems to suggest that development and democracy go hand in hand: Przeworski et al. * famously asserted the stylized fact that once a level of $* per capita is achieved democracies never fail. The focus of USAID is currently on this type of effort, building civil society institutions and developing economies with the understanding that governmental forms will adapt to the changing societies.

The results of this study reemphasize the need to consider also the incentives facing government leaders. Most successful democratic transition is evolutionary rather than revolutionary, and therefore requires not only the will of the governed but the consent of the governors. Changing civil will and capacity can and does affect the incentives facing government leaders, but societal factors do do not completely determine leaders' incentives. Factors such as GDP per capita are still found inhibit democratization in this sample, as they do in the rest of the universe, but other variables are also highlighted.

This paper presents a twofold empirical basis for this argument. First, viewing the state as the object of study, the way in which these surprisingly-democratic states differ from others is on state-level, but society-level variables. There is no reason to suspect that the citizens of these states are more powerful, more democracy-loving, or more capable of collective action than other citizens, but the states and their capacities do differ in fundamental ways. Microstates are from the same cloth as other states, but are cut differently; and the shape of the state as well as the texture of the civil-society fabric determine whether the outcome will be democracy or dictatorship. Second, among the small states considered in this study, I consider what variables set the democratic trend apart from the nondemocratic outliers. Again, it is not only civil-society variables but also state-level variables that set democracies apart from dictatorships. Wealthy countries, European countries, and countries that do not have a majority Muslim population seem to do better, but key differentiators seem to be dependence on the sort of credibility-market revenues I discussed earlier.

Methodologically, the main task this paper faces is to do something useful with a sample size of 32 countries. Not only do studies on democracy omit these small states, but they are omitted from a number of other data sources as well. Standard measures such as foreign trade, central government expenditure, external debt, risk premium on loans, natural resource exports, and foreign aid are often missing. GDP data sometimes do not exist or are inconsistent. This is not mere missing data, but censorship. GDP data are often missing because of civil wars; countries that do not report central government expenditures may be less transparent; and in every case data are less likely to exist where states are smaller, and the premise of this paper is that state size covaries with things of interest. Second, where data do exist they have little of the sort of historical depth that would allow us to repeatedly measure the effect of a change at time t on variables of interest at time t+1. A final problem is that these democracy scores are ordinal rather than metric: there is no reason to believe that the difference in democracy between a Freedom House score of two and three is the same as the difference between eight and nine, or that a similar level of disturbance would be required to produce these changes in effect.

For these reasons—data omission or censorship, lack of historical depth, and nonlinear scaling—the methodologies employed in this paper will be crude at best. It does not make sense to invest in laser-precision analysis when your measurements are still in the stone age. In the first task,

comparing microstates to the rest of the world to prove they are different, some quantitative analysis is possible. The main goal here is to convince the reader that "something is going on," i.e. that microstates behave differently from the rest of the world, and regression is not useless for that purpose. The second task, comparing the microstates among themselves and determining which independent variables separate democracies from nondemocracies, requires purely qualitative methodologies for reasons of sample size and data availability.

This paper will proceed in three sections. In the first section I will present the empirical finding and defend it from the obvious alternative explanations. The second section will develop the theory of the cause of microstates' surplus democracy. Finally, in the third section I will present qualitative analysis of the population of microstates to test the theoretical mechanism I proposed.

I. The Result

First some definitions. Freedom House annually assigns each independent state and some other administrative regions two scores based on the level of political rights and civil liberties enjoyed by the territory's residents during that year. These scores range from seven, a high level of government restriction, to one, a low level of government restriction. In other words, lower scores indicate that a country is more democratic. For the purposes of this paper, I used the simple sum of the two scores to measure the level of democracy in a country.

There are both obvious advantages and drawbacks to such a scale. Przeworski et al. * prefer the most directly definitional measurement of democracy: a country is a democracy if the people can replace the government, i.e. there is some probability that a regime will surrender power due to an election. One knows if this probability exists only by repeated observation. If a regime changes after an election, we assume that previous elections could have had that result also, and so retroactively observe that the country was a democracy. This obvious drawbacks of this measurement are that it relies on counterfactuals to measure, and that as a binary it doesn't capture the gradations of democracy. For example, voting fraud, official corruption, patronage, political restrictions, and intimidation of the press may have the effect of making power transitions more difficult but not impossible. Perhaps the government will accept an election result, but these restrictions shift the electoral burden on an opposition party by perhaps 20 points — they must have a "natural" or "objective" support level of 70-30 in order to get enough supporters informed and out to the polls to overcome the government's advantage. This is less democratic than a 60-40 democracy, which is in turn less democratic than a 50-50 democracy. Perhaps Przeworski et. al are correct that one knows a dictator when he ignores election results, but respect for election results is not sufficient to call a country purely a democracy. There are finer gradations.

A second definition is Dahl's conception of polyarchy, close to the American conception of checks and balances. If the military, the press, the courts, the executive, and the body writing electoral laws are separate and independent, they have less systematic power to restrict the expression of the popular will. I suspect that the Freedom House scores actually come relatively close to measuring what Dahl proposed people measure. In any case, the choice of measures is dictated by availability: any shortcomings in the measurement are not enough to justify the creation of a new measure.

For the purposes of this paper, I define microstates as formally independent, internationally recognized countries with a total population of less than 475,000 persons in 2002 as estimated by the World Bank. There are 32 such countries, listed in Table 1.

The cutoff 475,000 was chosen based on inspection of the data rather than on some theoretically-

derived prior, and so significance estimates are to be taken with a grain of salt. There is probably a theoretically-sophisticated way to estimate the amount of extra significance you could get by choosing a cutoff from the data, just as for outlier analysis with n data points you demand $p < p^*/n$, but such an estimator would require the introduction of a theoretical model whose simplifications are either arbitrary distortions of a scale greater than that introduced by the original estimation, or are derived from inspection of the data and so suffer from the same flaws. Unfortunately the available sample is small enough that we do not have the luxury of deriving a model from part of the data and testing it on another part. Perhaps this is unprofessionally crude, but I would recommend that the reader mentally double or triple p-values associated with the microstate parameter based on the definition's estimation from the data. Note that the cutoff point is not chosen so as to minimize p-values: I first discovered this effect by including a dummy for population less than 300,000 and the probability level was lower by a factor of about two than that for a dummy at 475,000. (States with less than 300,000 citizens have average scores of three, while the 300,00-475,000 range has an average score of four, an increase but not a break in the data.)

For theoretical purposes, it is important to describe the process of microstate formation: how are states "assigned" to the group of microstates or the group of non-microstates, what factors are likely to covary with this "assignment," and can we consider the "assignment" random given the values of covariates, or is population an intrinsic quality rather than an assignable treatment? I would argue that, in fact, state borders are more or less randomly assigned (aside from the fact that many of these states are islands, which will be addressed in the subsequent subsection). It is a trope of such unradical sources as high school history textbooks that colonial boundaries were drawn arbitrarily: the standard example, illustrative if perhaps apocryphal, is a bump in the Kenya-Tanzania border because Queen Victoria's gave Kilimanjaro to her cousin the Kaiser as a birthday present. Likewise European boundaries are not systematic enough to be expected to correlate with anything of interest: Liechtenstein's independence from the Holy Roman Empire in 1806 tells us little about anything we might care about. In sum, there is no reason to believe that when the modern borders were drawn, they reflected any quantity of interest to us that might affect democratization.

Are Microstates More Democratic?

Microstates are more democratic. Graph 1 plots Freedom House democracy scores against population (on a log scale to show what's going on at the small end of the spectrum). Graph 2 introduces artificial autocorrelation to make the trend more visible. Using a simple t-test gives a probability value of 1.39×10^{-6} (difference in means = -3.7794, t=-5.003). Table 2 presents a regression suggesting that indeed the microstate variable, rather than population or its log, is the variable of interest.

The potential confound, noted earlier, is that many of these states are small islands. In experimental language, their status as islands was correlated with the boundary "assignments" that constituted the microstate "treatment," and island status covaries with a number of other quantities of interest. Three specific quantities come to mind.

First, islands intrinsically do not have neighbors. This may mean they are less likely to be destabilized by foreign-backed insurgents or smugglers. It may also mean that they have greater control over their own populations because it is more difficult to flee. Third, it may mean that the population, which cannot flee, is more resistant to repressive government or is less mobile and more attached to the polity. It is not theoretically clear how this variable should operate, but we should not be surprised if it has a confounding effect.

Second, islands may be economically isolated due to higher shipping costs. Increases in trade, especially with democracies, has been cited as an important factor in democratization (*Marinov). This pressure toward autarky, however, is likely offset by lower population: though islands may trade less across international borders, states with very small populations are likely to depend more on resources they cannot produce internally, and this effect is likely to dominate. As a second factor, islands may develop comparative advantage and economies of scale in shipping and transport, and so may be used as transshipment points or may become the interlocutor merchants. Third, islands were likely to be colonized by the global naval hegemon, either Britain or the United States. Much has been made of the economic effects of a common-law system. If British or American colonies fared better constitutionally, this might be a confound.

In order to control for these factors, I included two dummy variables in the quantitative analysis. The first took the value of one if the country was an island, defined as a country with no international borders according to the CIA World Factbook. The second took the value of one if the country was a former or current part of the British Empire or Commonwealth. I was unable to find a systematic list of former American colonies (the CIA World Factbook, unsurprisingly, was no help). Finally, I included a variable for the log of national GDP per capita according to the World Bank because of the strong relationship between development and democratization. In that regression I omitted countries where GDP was missing.

Graph 3 shows the effect of wealth (log scale) on democratization scores. The results are unsurprising: wealthier countries typically have lower (more democratic) scores, though the trend is not perfect. Nevertheless, it appears that at every wealth level microstates are consistently more democratic than their normal-sized counterparts. To emphasize this observation, trend lines for the two groups were added in Graph 4.

Graph 5 shows the effect of having been colonized by the British Empire on democracy scores, controlling for population. There does not seem to be any effect, as the trendlines added in Graph 6 affirm. Although British-empire states are indeed roughly a half-point more democratic on average than other states based on Freedom House measurements, either this is because they were more likely to colonize islands that then democratized better, or because the British set international borders smaller and so created more microstates. In any case, in a regression in which log population is included the British empire dummy has close to zero effect ($t \sim .01$), and when the microstate parameter is included the sign of the British empire reverses: the British created more microstates and so appear more successful, but within categories they did worse than the rest of the world.

Finally, Graph 7 shows the effect of status as an island. The island and microstate variables are quite highly correlated. Islands are more democratic based on a simple comparison, but it turns out that, with log population or the microstate dummy in a regression, that islands are not more democratic than other countries.

In sum, it does not appear that any covariate from the assignment process is affecting the results, and we can treat this as a natural experiment. Table 3 documents this finding. The astute reader will likely have other problems with the dataset: the three European independent principalities could clearly be claimed to be unrepresentative of the larger population of independent states. Likewise, several small islands of naval importance signed “Compacts of Free Association” with the U.S. as a condition for their independence and are probably somewhat circumscribed in their ability to diverge from U.S. wishes. These “sort of” independent countries are documented in Table 1. The number of countries with such status is relatively small, and they clearly do not drive the results. In the end, we can keep coming up with reasons all day to throw out this country or that country, but

with a sample size of 32 it's preferable not to throw out countries, and clearly there is no small subgroup of these states that is driving the empirical result.

Do Microstates Democratize Faster?

The work on democratization has mostly been based on binary codings and annual hazard rates for transition. The data presented here is not in that form. However, it is reasonable to ask whether microstates were born more democratic or became more democratic than other states in the interim. If they were born more democratic, it might suggest that they were administered differently by the colonial power — for example that microstates were trading hubs rather than resource-extraction centers.

In order to answer this question, I test to see whether Freedom House scores for microstates changed more than they did for other states. I compare current scores to 1990 to avoid Cold War politics confounding the analysis — perhaps microstates got extra foreign aid for their U.N. votes, or perhaps they were neglected in bloc-formation ("who lost the Seychelles?" just doesn't have the ring of "who lost China?").

This part of the analysis proceeds without control variables. Including 2002 GDP in the analysis raises huge endogeneity problems; trying to find 1989 GDP would reduce the sample size too almost nil; and all of the other variables of possible importance are invariant, unimportant, or both.

Change in Democracy Score 1990-2003 By Category

	1990	2003	change
Non-micro	7.88	6.88	1.00
Microstates	4.81	3.86	0.95

It seems that microstates did no better than non-microstates: both improved by roughly one point on the scale. (Only the purest scientist will object to my convention of using "improvement" to mean an increase in democracy.) However, this similarity is an illusion. The problem is that it is not appropriate to compare changes in democratization scores from different starting values. There is no reason to believe that a change from three to two is equivalent to a change from nine to eight, and in fact, it is not.

In 1990, microstates had typically much better (lower) Freedom House democracy scores than other states. For example, 50% of non-microstates had 1990 democracy scores of nine or worse, and those in this category improved by an average of 1.93 points. Microstates within this group improved by an average of four points, but only 20% of microstates had such poor democracy scores. Thus, though microstates improved much more than large-state counterparts, this improvement carried less weight in the overall average because there were fewer microstates with so far to go. Similarly, around 50% of microstates had perfect democracy scores of two or near-perfect democracy scores of three, and so had little room to improve. Only 20% of non-microstates had such good democracy rating in 1990. There was little net change among either microstates or non-microstates who scored so highly, but there were more microstates who did so, and so a greater percentage of microstates showed no change. Table 4 shows the breakdown of microstates and non-microstates by initial democracy score category and the average amount of improvement of states within that democracy score group.

Matching by initial score, it turns out that if non-microstates had the same improvement within each category as they did in the real world, but counterfactually had the same initial distribution of

democracy scores as the microstates, their average improvement would have been only -0.44 units. (The reverse calculation is impossible to make because we don't know how microstates in many of the highly undemocratic categories would have performed, as there were no examples to infer from.) In sum (making the standard likely-untenable assumptions), we can say that microstates improved more than twice as much as non-microstates would probably have done from the same starting point. Although the change in average scores proved identical, the change in the microstates was a bigger change.

II. Theory

What is the source of these microstates greater tendency to democracy? The natural answer is Rousseauean: politics does not merely aggregate individual wills into a social choice, but rather requires the creation of a general will through discourse and mutual identification. Small polities are better at doing this, the argument would go. If the theory is correct, small-scale polities would have a fundamentally different politics, and one that tends more toward democracy. Perhaps atrocities are harder to commit or untrustworthy leaders are likely to be known as such before elected if everybody is a friend of a friend. That theory is not really plausible though. If we were talking about student body presidents at midsize universities that might work, but these countries are the size of Las Vegas or Oakland. It is simply not the case that Las Vegas has a different kind of group feeling because everybody knows each other and can relate to each other.

More broadly, Fearon and Laitin's (*) work on civil wars has suggested that the motivating emotional primitives — in their case, ethnic grievance — are universal, and so in a social-science, predictive sense the important variables are permissive — in their case, the success prospects for insurgency. Of course, in my case I don't have the same sort of high-quality data they do. But nevertheless, it is reasonable to suggest that there are the same types of people in the same proportions everywhere — people who love their neighbors as they love themselves, and people who love wealth stolen from their neighbors as they love their own wealth — and that we need to look at the prospects for each and the choices they will make in order to determine the likely outcomes.

A better literature to turn to than Rousseau comes from the economic study of institutions and the problem of the appropriability of rents (*citations for this whole section are missing - probably Coase, North/Weingast, Kreps?*). In this section I will review arguments from the literature (1) that the ability to make credible commitments is at the heart of the appropriable rents problem; (2) that institutional checks on arbitrary power are a solution to the credibility problem; and (3) that, following the corporate culture literature, democratic decisionmaking must be consistently applied and generate reputation effects in order to generate high credibility. I then informally consider a game between investors and governments and show that the comparative statics of that game lead to the empirical result discussed in section I, as well as supporting other main empirical findings of the literature on democratization.

The standard example of appropriable rents involves the Fisher auto body company, which made the bodies for Ford. Suppose Fisher bodies cost $3 in capital costs and $3 in unit costs to produce and are worth $10 to Ford, and that Chevrolet's designs are different and so Fisher's Ford bodies are worth only $5 to it. If Ford promises $8 a body, Fisher should go through with it and both will make a tidy profit. However, once the Fisher plant is built to Ford specifications, what if Ford decides to drop its offer to $5.25? If Ford offered only $4 Fisher could go ahead and sell to Chevrolet instead for $5, but as it is, Fisher has no choice but to accept the worse offer. Of the $7 quasi-rent that Fisher makes on each car body, $5 is appropriable by Ford because the next-best

use of the $10 Ford auto body by Chevrolet is worth $5 less. Since the non-appropriable rent, $2, is less than the value of the capital, $3, Fisher will choose not to build the plant. The solution that makes everybody better off is for Ford to tie its hands so it can't or doesn't want to take advantage of Fisher — if it credibly pledges not to go back on its $8 offer, everyone is better off. (The standard solution is for Ford to buy Fisher.)

Consider now an investor starting a agriculture business in an ordinary-sized state, say Zimbabwe. The investor can keep her $10 under the mattress, or can use it to buy $10 in seed and raise $20 worth of crops. Once the crops are ready to harvest, though, what if the government announces that 25% of all crops are being seized? In this case, the investor's rents are cut in half, but it's still better than if she kept the money under her mattress. She is therefore willing to make the investment if and only if the government can credibly commit to seizing less than half of the crops, but if she suspects that the government may seize more than 50% of the crops she will keep the money hidden under her mattress.

How might the government make such a pledge? The standard answer is that the government can make a credible commitment by designing an institutional check. For example, when the British King was trying to raise money to finance wars with France, he was always tempted not to repay the loan. However, when the investors were given authority to tax, collect, and disburse revenue and check the King's spending through the creation of Parliament, they became far more willing to loan money to the crown. Borrowing from the literature on corporate culture, though, we see that to build citizens' general confidence in government, they need to know well how the government will react to unforeseen circumstances. An agreement from the King not to issue debt or spend money without Parliament's approval will make their loans more likely to be repaid, but in order to give an investor a very high degree of confidence one would need to create a more general decision rule about how Parliament and the King would cooperate. Maintaining this cultural decision rule would be valuable to the King because it enables him to inspire confidence and thus to collect more revenue. The idea is that a set of specific proscribed actions (e.g. not reneging on debt payments) is not enough because the government will face unforeseen circumstances. It is only enough to create and maintain a reputation for a certain type of conduct and way of making decisions in unforeseen circumstances, because that reputation will become valuable and leaders will thus protect their reputation even when they have a short-term incentive to violate it. Only then can investors have confidence that the government will not reinterpret agreements unfavorably in unforeseen circumstances.

Thus, a high degree of investor confidence requires the sort of legal and day-to-day government respect for citizens' rights that is measured by the Freedom House scores.

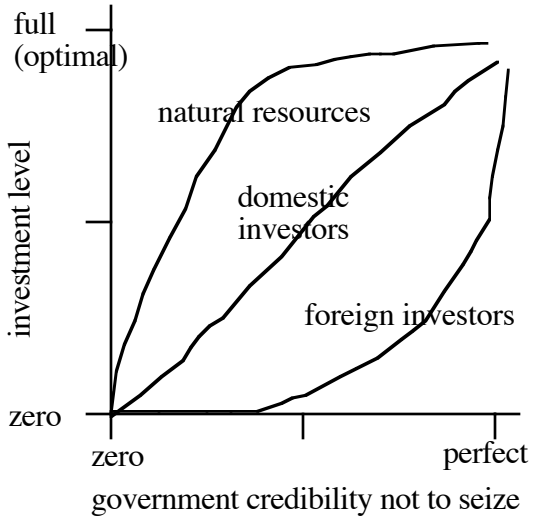
We considered already the sort of investor confidence threshold required to get Zimbabwe's economy running: investing in crops had to be better than keeping the cash under the mattress. Now let us consider the interaction between a U.S. investor and the Zimbabwean government. Here the second-choice option is not putting the $10 under the mattress, but rather investing it somewhere else, perhaps for an $18 return. In this case, the appropriable quasi-rent once the investment is made is the same $10, but because the next-best use of the money is better before the investment is made, the investor will only be willing to allow less than $2 to be appropriated. If the Zimbabwean government seems likely to seize more than $2, the investor will go elsewhere.

Now consider the the following game structure, repeated over time. First, a country's leader decides what level of democracy to practice, in other words how much to invest in a reputation for clean conduct and how much to institutionally tie its hands. Second, domestic and foreign investors decide what level of investment to make. Third, the leader decides how much of that investment to

seize.

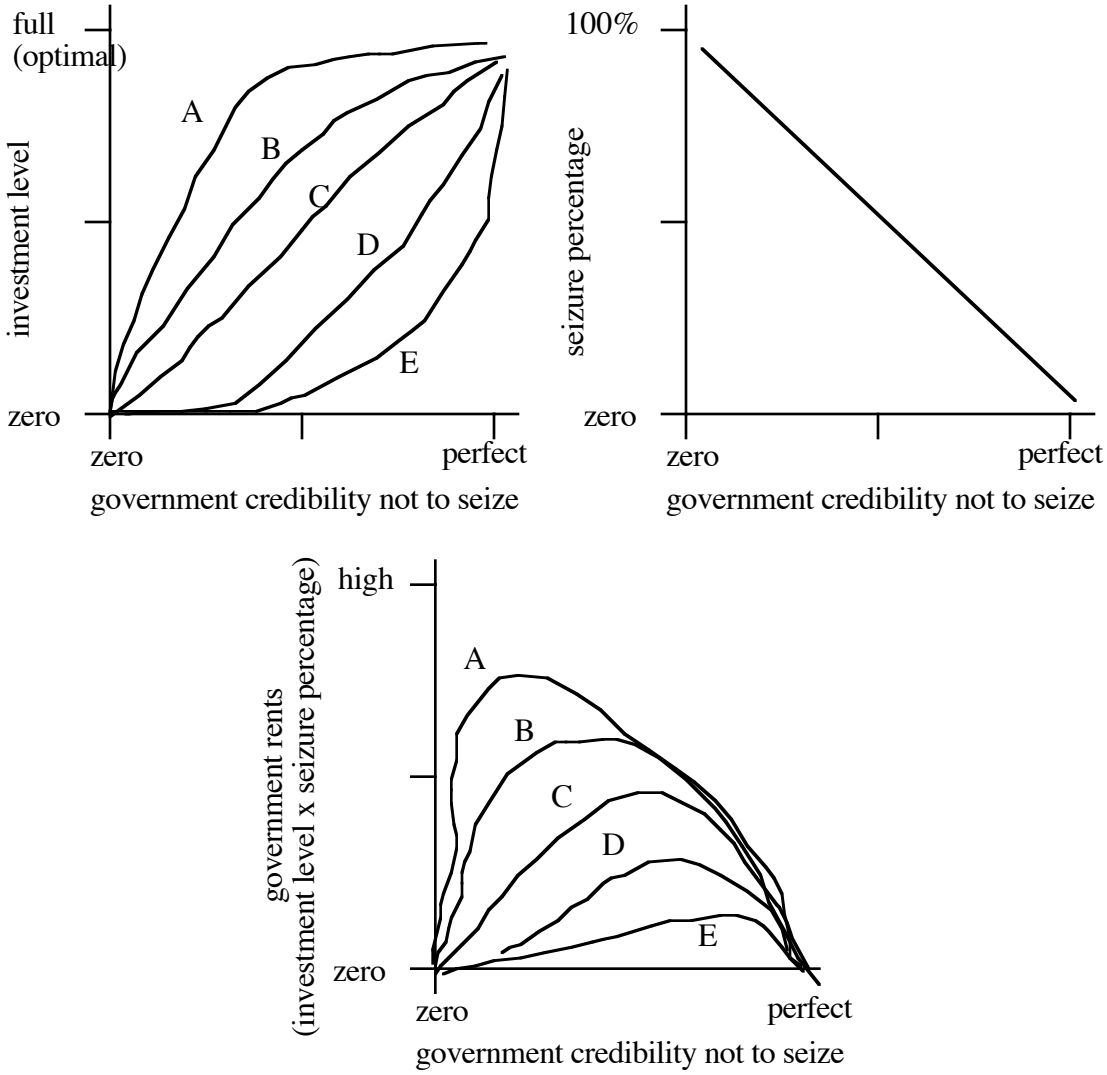
We consider the game by moving backward through the game tree. In the last stage of the game, as the corporate culture argument shows, the government has a strong incentive to live up to the promises it made at the outset (and will have made promises it can live up to, as we will see). This is either because it has no choice, due to an institutional solution like Parliament, or more realistically because it finds these institutions and decision-rules binding for their reputational value. Therefore, in the last stage the government seizes the amount of property it promised.

In the middle stage the investors evaluate the government's likely behavior and make a decision to invest based on the second-best possible use of their money. Domestic constituents will invest in a project if government seizure rates are likely to take less than the full return, because they have little choice other than keeping their assets uninvested. In contrast, international consituents are likely to demand a quite low rate of defection and asset seizure because they have a large number of relatively interchangeable options for investment. The clear exception is in natural resource extraction, where rents are so large, and such a large amount of the rent is location-specific and clearly under the control of the state, that investments will still be sensible even if the government is expected to take a large share of the revenue. (Furthermore, oil companies typically have the clout to either enforce their agreements or ensure that they are enforced by somebody else.) In sum, each of foreign investors, domestic investors, and natural resource investors will choose a different level of investment based on the level of credible commitment the government has made not to expropriate them. Natural resource extraction investments are profitable even when government commitments are not generally credible; domestic investment will increase steadily with commitment credibility as more projects have the return rate necessary to justify expropriation risks; and foreign investors will typically be able to find a better offer unless credibility is quite high.



What signals does the government then choose to make at the outset? Given that there are reputation effects and so the signal is expensive, it will choose to make a signal that is credible rather than throw away the chance that it has to convey some information to potential investors. Thus, knowing that investors will disregard incredible signals and it will suffer reputation costs needlessly if it defects, the government will make a reputational and institutional promise that it will keep to in the final period.

In order to maximize its incoming revenue, the government will select a commitment level based on the share of each investor type, i.e. the shape of the total investment function. The government rent function will be the product of the investment function times the seizure rate, as depicted below.



Note that the maxima shift to the right as investors shift from natural resource investors with a huge incentive to stay, to ordinary domestic actors choosing between investing and hiding their cash, to overseas investors who will put their money wherever there is the highest rate of credible return.

Because the governments of microstates make a greater proportion of their transactions with foreigners, they have a greater credibility premium, and so will choose to behave more democratically. That is, while most states are looking at rent curve C in the figure above, microstates are looking at rent curve E and so prefer a higher level of constitutionalism. Corporations choosing a tax haven or offshore banking location, tourists picking a destination, shippers looking for a transshipment port or a flag of convenience, or fishing corporations looking for licensers will

demand very high levels of credibility or will refuse to invest; and the government leaders in the microstate will be better off if they provide this credibility. The revenue stream in a microstate without foreign rents is small enough that it is more fun to be president than generalissimo in a typical microstate.

Note how well this finding accords with the existing literature on the resource curse: when a state is not dependent on its citizens for revenue, it is likely to become highly undemocratic. (*cite)

III. Qualitative Analysis

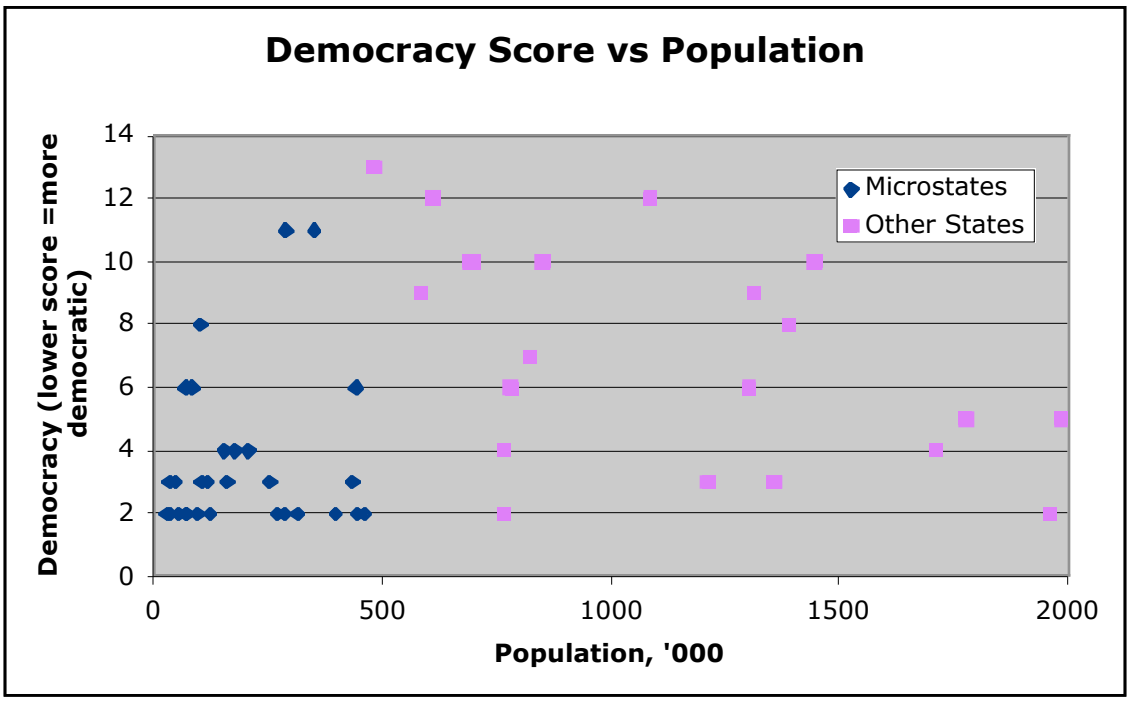
This part of the paper is just not written yet. The basic idea is that when you look at the list of countries in Table one you see three types:

1. democratic countries that are doing OK with tourism, fishing licensing, offshore finance, tax evasion, etc.
2. nondemocratic countries that just suck, that are living off subsistence agriculture and foreign aid
3. nondemocratic countries that have natural resources like oil

The observation is that if you are undemocratic and can't make the kind of commitments you need to in order to attract tourism and finance, your country isn't going to be able to raise revenue. that's cool unless you have oil. so basically in a small country without natural resources, it's more fun to be a democratic leader of a successful country than a tinpot dictator pushing around subsistence farmers.

GRAPHS (tables afterward)

1.



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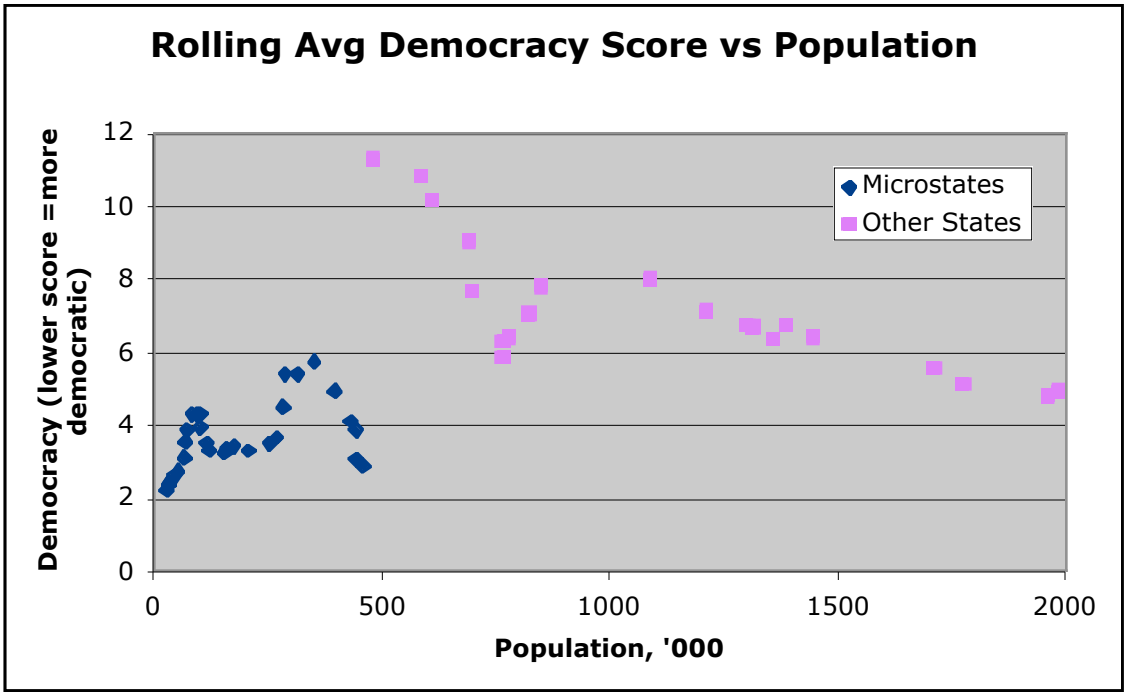
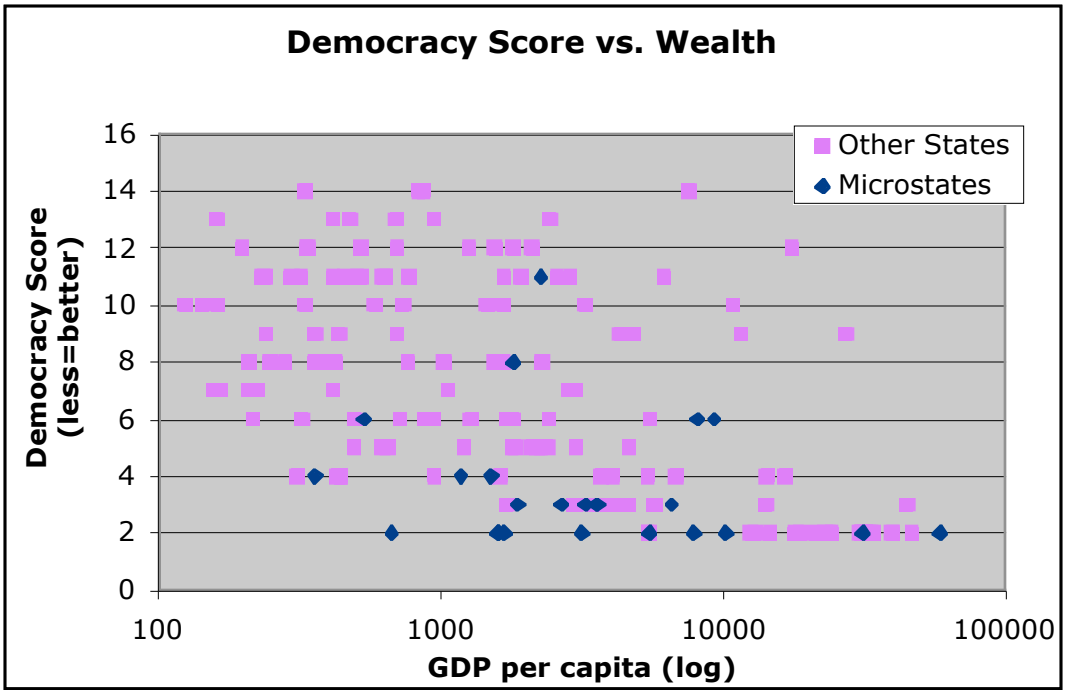
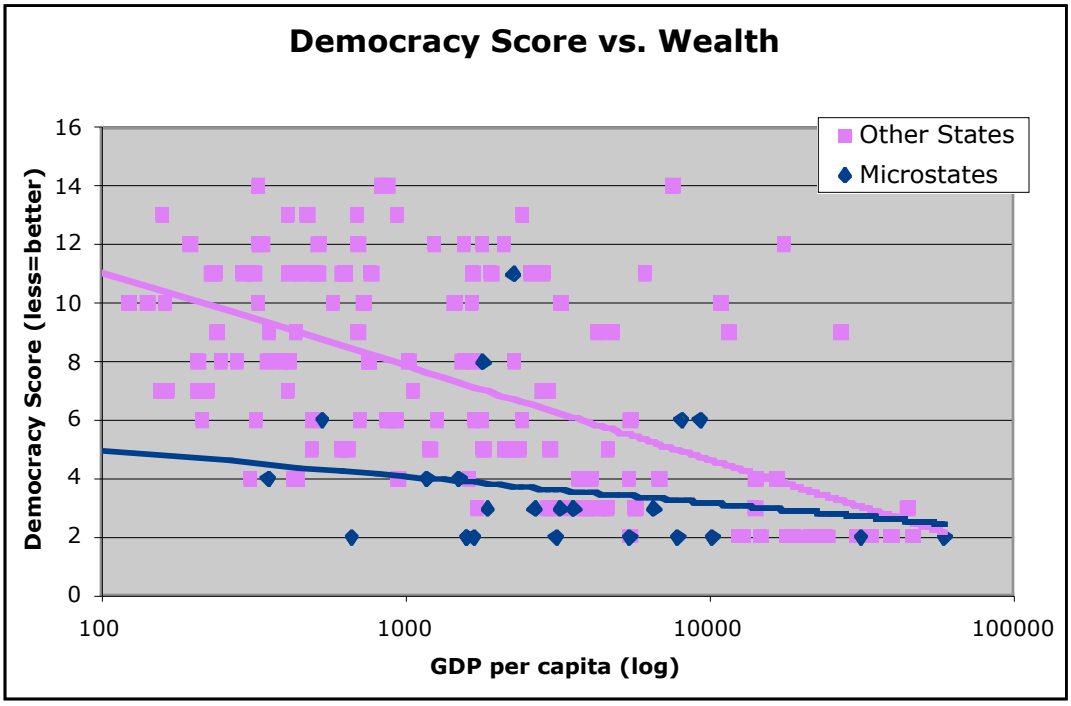


*The data are artificially serially correlated by replacing each data point with $y_4' = y_1+2y_2+3y_3+4y_4+3y_5+2y_6+y_7$ for y_i in the same category. The idea is that if there is some predictable "signal" or trend and some noise, this autocorrelation will average out the noise.

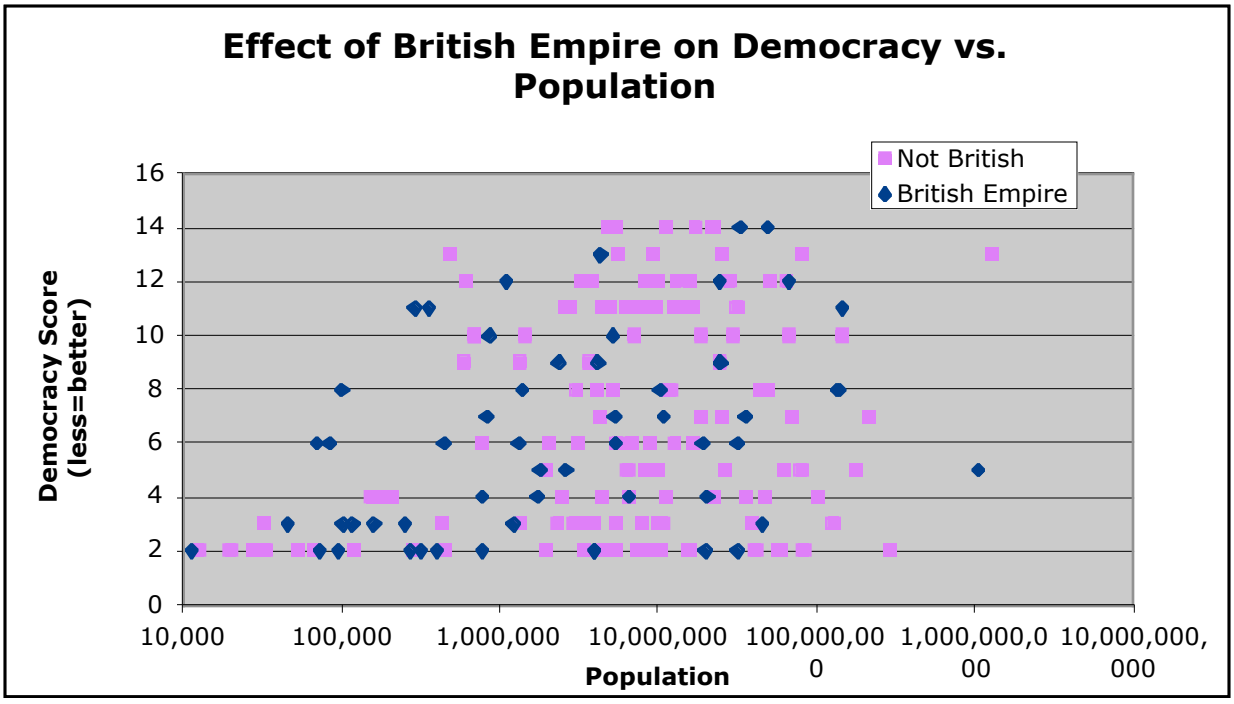
3.


Democracy Score vs. Wealth
Other States
Microstates
Democracy Score (less=better)
16
14
12
10
8
6
4
2
0
100
1000
10000
100000
GDP per capita (log)

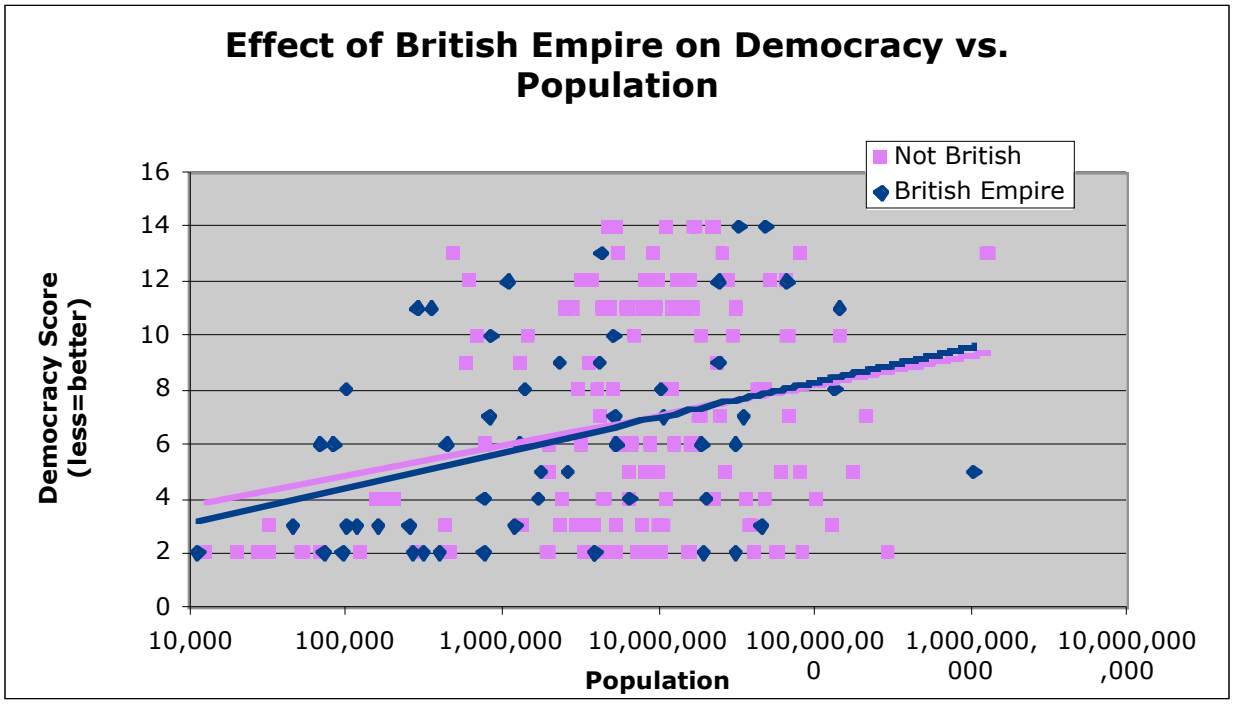
4.


Democracy Score vs. Wealth
Other States
Microstates
Democracy Score (less=better)
16
14
12
10
8
6
4
2
0
100
1000
10000
100000
GDP per capita (log)

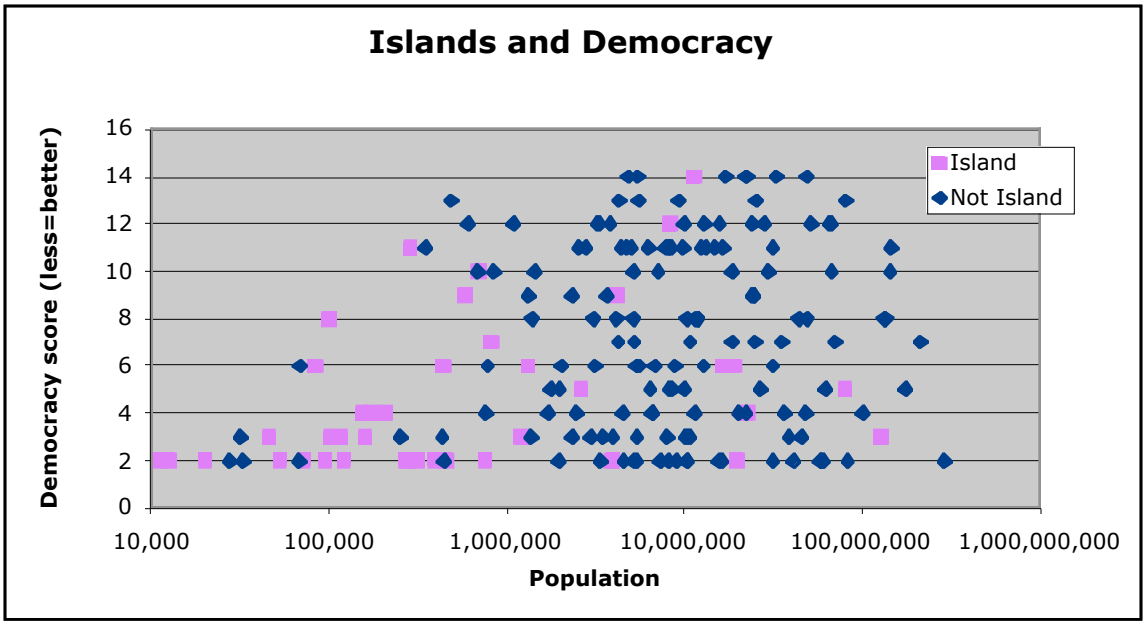
5.


Effect of British Empire on Democracy vs. Population
Not British
British Empire
Democracy Score (less=better)
0
2
4
6
8
10
12
14
16
10,000
100,000
1,000,000
10,000,000
100,000,000
1,000,000,000
10,000,000,000
Population

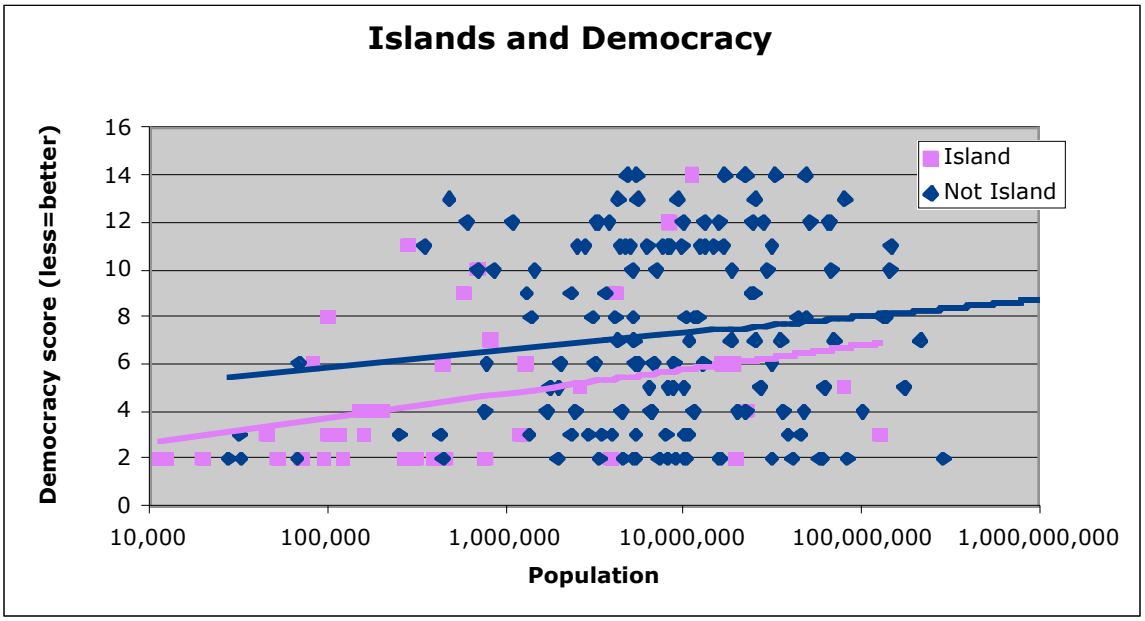
6.


Effect of British Empire on Democracy vs. Population
Not British
British Empire
Democracy Score (less=better)
0
2
4
6
8
10
12
14
16
10,000
100,000
1,000,000
10,000,000
100,000,000
1,000,000,000
10,000,000,000
Population

7.



8.



Note that the lines have low slope because log population explains little of the total variance; and the island line is lower because islands have an overall lower mean. The fact that the island line is everywhere lower than the not-island line does not indicate that the average is lower in either category.