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Groundwork

When global financial markets crashed in September 2008 our countries—Denmark, Ireland, and Switzerland—were hit especially hard. They required substantial assistance from the U.S. Federal Reserve and the European Central Bank (ECB) because their own central banks did not have enough resources to shore up their financial systems. Policymakers and bankers felt vulnerable. Fear became general. "We did not know whether in the first quarter of 2009 we all were on our way to hell!" noted one Danish banker, thereby capturing the general mood of an unprecedented situation that nobody knew how to handle.[1] Yet Denmark as well as Switzerland displayed considerable resilience in the face of the crisis, thereby showing that the forces of globalization do not necessarily overwhelm small countries. They performed well thanks to thick political and economic institutions, best defined as professional, expert-oriented and nationally focused; politically inclusive; legitimate and trustworthy; and possessing well-developed organizational capacities. We will show that these institutions result from successful nation-building and state-building in the face of continual geopolitical and economic vulnerabilities. In contrast, Ireland did less well: the independence of the state is recent, its nation-building incomplete, and its institutions comparatively thin.

Much has been written about the policies that different countries adopted to handle the financial crisis. Far less has been written about the processes by which these policy decisions were made and the institutional contexts that shaped them. In particular, virtually nothing has been written about the ways in which patterns of national development affected these more proximate factors. We will show that one cannot fully understand what happened in the

1 Interview with Peter Straarup, former CEO, Danske Bank.

countries that concern us without appreciation of such historical patterns. It is as well to stress that this makes for an ambitious book. A brilliant paper by Charles Kindleberger that came to our attention as we were completing this book suggested that understanding trade and economic development across nations in the nineteenth century required "a rounded theory of social behavior [that] would include economic drives as only one strand in a broad web of social motivation," an argument interestingly reinforced by an incisive and accurate analysis of Danish economic development.[2] The general statement precisely captures our intent and the result of our research: economic performance cannot be understood without the contribution of sociology.

Some clarification of terms is needed immediately. What we mean by a small country is not as straightforward as one might think. Smaller countries typically have fewer people and less arable land than larger ones, which means in many cases that they also have fewer and less diversified resources than larger countries. The size of their domestic markets also tends to be small. Further, when it comes to international relations, their power is generally dwarfed by larger countries; they are often rule takers rather than rule makers. The implication of all this, discussed in detail later, is that small countries tend to be vulnerable to external forces to an extent unfamiliar to larger ones.[3]

The nature of the nation is even more complicated and the subject of intense debate—which, however, can be resolved for the purposes of this book. It certainly is the case that some shared sense of ethnic, religious or linguistic similarity can facilitate the creation of a nation. But total cultural homogeneity in terms of language, ethnicity, and religion is not necessarily required for the creation of a fully developed national identity. Despite linguistic and religious difference there was some sense of Swiss identity very early on, as we shall see, even though it was only at the end of the nineteenth century that various festivals and nationalist myths consolidated the nation. Crucially, nationalists are liable to mislead the unwary because they so often put forward the view that the fully consolidated nation was always extant, merely asleep, waiting to be awakened. In fact a nation develops over time, moving, to use Marxist terms, from something in itself to something for itself—or, to use different language, from merely nominal status to something substantively present in daily life. The same point can be made about the state, the centralized political apparatus responsible for providing order internally and protection against external threats. States develop gradually in response to modern social conditions. The strength of a state is enhanced when it is the home of the people: democratic, highly educated, and provided with welfare. This leads

2 Kindleberger 1951, p. 30.
3 The general point is now forcefully made by Abulof (2015).

to a very simple conclusion. The culmination of these two processes—nation-building and state-building—is the modern nation-state, the home of the people in every sense.

We have already claimed that our work will contribute to a broader and more complete view of the workings of economic life. But that aim might have been reached in other ways. So why should we care about a few small nation-states? One answer is simple: even the puny deserve attention! However, there is a larger theoretical issue. The theory that we offer about small nation-states suggests that the ability to act flexibly and quickly can help explain success within capitalist society. Earlier statistical papers certainly suggested that this is so.[4] The point is that there are also lessons here for larger countries. They may need to foster greater national unity and institutional resilience if they are to navigate effectively in an increasingly volatile world political economy. As small countries have been more exposed historically to international vulnerabilities than larger ones, the analysis of their social formations provides an especially clear view of the factors affecting resilience relevant nowadays to all countries.

There are additional reasons of a more academic sort that explain why this book should appeal to readers beyond those interested in small nation-states. First, it weds the insights of two very important social science literatures that rarely speak to one another, one on comparative political economy, the other on nationalism. Second, our arguments contribute to recent scholarship on how ideas as well as interests affect institution-building and policymaking, and they do so with a particular twist. The scholarship on ideas within comparative political economy focuses on the influence of economic frames and paradigms such as Keynesianism and neoliberalism while largely ignoring more general political cultures. Our emphasis on nationalism fills an important blind spot in the discipline.[5] Third, we offer a lesson about one economic paradigm in particular—neoliberalism—that went terribly wrong in some countries by convincing policymakers to limit government regulation of financial markets. As is well known, this led to disaster: the 2008 financial crisis. Although our emphasis will be on the ways in which thick and thin institutions affected responses to the crisis we show as well that institutions influenced the manner in which policymakers embraced neoliberalism in the run-up to the crisis. Finally the book speaks to the literature on the financial crisis from a new and broader perspective. Previous studies have tended to be

4 Patsiurko et al. 2012, 2013.

5 For a review of the literature on ideas, see Campbell (2002). Vivien Schmidt's (2002) comparison of different national-ideological styles of policymaking moves in our direction but does not focus on national solidarity. An important exception that does take nationalism seriously is Helleiner and Pickel (2005).

sector specific rather than taking into account the wider national political economy: Cornelia Woll concentrates on the organizational capacities of the banking industry in her analysis of crisis management.[6] Stephen Bell and Andrew Hindimoor analyze the industry's incentive structures, noting that they varied across countries.[7] Research on the U.S. financial crisis most often describes institutional and ideational factors specific to the financial services sector.[8] Our analysis situates such facts within nation-state–building processes that gave rise to the institutions characteristic of each country's social formation. So there are lessons here for the comparative political economy of advanced capitalism.

Vulnerabilities of Nations and States

Every small child knows what it feels like to be bullied by someone larger and stronger. Such a child feels vulnerable at all times, full of fear on occasion. Such sentiments are felt strongly in the international arena both by nations and states. The most obvious reason is that both entities know full well that they may cease to exist. The historical record is full of small states that have disappeared, gobbled up by their neighbors. Burgundy boasted the greatest court culture of the late Middle Ages, but is known to most today only as a center for wine production. Equally, cultural traditions, often based on distinct languages, disappear all the time, something of which we are reminded by attempts to revive Welsh, Breton, and Gaelic.

Small nation-states that have survived are well aware of these factors. They remember that their own survival has often depended upon forces that they could not control. Denmark is a clear example: none of the Great Powers wanted the entrance to the Baltic to be controlled by a rival, all thereby preferring control to be exercised by a smaller entity, and so sought the preservation of Denmark at various moments when its very existence was in question. Put differently, among the great vulnerabilities faced by small nation-states are geopolitical threats, the prospect of conquest by a larger state able to destroy sovereignty and to extirpate culture. Small states accordingly seek alliances and long for schemes of international order. Russia's recent military incursion into Ukraine shows just how real such vulnerability remains even today. For similar reasons, small nations seek their own states when possible, but otherwise work hard to gain cultural rights. Quebec provides a clear instance of the latter: fearful that its identity would be destroyed if its language lost salience, it has fought hard and successfully to protect it.

6 Woll 2014. See also Grossman and Woll (2012).

7 Bell and Hindimoor 2015. See also Kirby (2010a) and Kluth and Lynggaard (2012).

8 Campbell 2011; Ziegler and Wooley 2016; and many of the essays in Lounsbury and Hirsch (2010).

Economic vulnerabilities loom just as large as geopolitical threats. For one thing, as noted, a large state can set the terms of trade for the small states that surround it and bend the rules of the international political-economic game to its own advantage, forcing small states to maneuver as best they can within them.[9] For another, small states are likely to have relatively few natural resources, which makes them dependent on the external world. Still more important is the fact that small size entails a small domestic market—and this, as any reader of Adam Smith will realize, limits the specialization of the division of labor on which increasing wealth depends. Eras of protection and self-sufficiency have made small states poor. They long for agreements establishing openness in the international economy, for this allows the access to large markets on which their prosperity depends. Of course, nations can be just as vulnerable as states in economic terms. Palestinians in the occupied territories suffer from nothing less than economic persecution.

One very important caveat is necessary. A distinction should be drawn between vulnerability as an objective condition (easily recognized in hindsight) and the subjective perception of vulnerability. One may be in a vulnerable situation without necessarily being sensitive to it.[10] What matters is whether the perception of vulnerability is strong enough to trigger action. All else being equal, perceptions of vulnerability are more easily translated into a sense of solidarity or "we-ness" uniting people in small countries than in large ones; it is easier to energize and organize a few people in a small country than many, especially if they have diverse backgrounds, in a larger territory. This allows us to make a comment about the currently popular term "path dependency." Large countries are likely to be dependent on patterns established historically, finding repetition easier than change—and are able to behave in this way because of their large size. The pattern of small nation-states is different: at best their path is often one of flexibility, their path dependency being driven by the vulnerabilities that they tend to have at the forefront of their attention.

If vulnerabilities come in different forms, as we have seen, it is just as important to note that these change over time. One general point worth making about the contemporary world of advanced capitalism is that small nation-states have found it to be essentially benign. Order reigns geopolitically, and a marked degree of openness exists in the international economic realm. It is this background situation that serves as the condition of possibility for the success of small nation-states in the postwar world. This is not to say for a moment that vulnerabilities have ceased to exist; no set of institutions of a

9 Hirschman 1945.

10 The distinction we draw between vulnerability and sensitivity is similar to that discussed by Keohane and Nye (1977).

platonic sort is or ever will be available given changes in the international environment. This is obviously true in the economic realm. Capitalism changes all the time as do the rules that govern its workings, making it ever more important for the small—bereft of large domestic markets—to stay at the leading edge of the product cycle. Furthermore, the economy is not so to speak pure; to the contrary it is an arena in which power is exercised and occasionally shifts. Two particular elements of power, discussed later in this chapter, can be noted immediately. First, the geopolitical strength of the United States allowed it to borrow heavily from countries with financial surpluses, failing to balance its own books and thereby contributing to its Great Recession, which stretched from December 2007 to June 2009. Second, German surpluses have to be absorbed by countries within the Eurozone just as much, and this occasions vulnerability—despite the benefits of open markets—because the monies on offer have contributed to extravagant bubbles, particularly in housing markets.

There are additional complexities. Some nation-states are independent and exposed to the international political economy; powerful neighbors provide a measure of protection in other cases. In Ireland, for instance, exploitation by an empire was ironically followed by a measure of shelter for the new secessionist entity. Something similar is true of Eurozone membership. Nation-states are more vulnerable insofar as they relinquish control over monetary policy to the European Central Bank and agree to open their borders to flows of capital, people, goods, and services from other member countries. But at the same time they enjoy the protections and benefits of Eurozone membership—greater currency stability, lower interest rates and bond yields, and access to structural funds—that facilitate development that might not otherwise have occurred given their small size.

An interesting contrast neatly making our main point concerns the rather different trajectories of Ireland and Finland. Both nations at the start of the twentieth century were contained within great empires (albeit the Irish had suffered from this far more than had the Finns) before gaining independence followed by civil war. But the vulnerabilities of the new nation-states differed in the ensuing years. Communists had played a role in the Finnish civil war, and the very real possibility of Russian interference thereafter meant that the geopolitical threat was real and immediate. In contrast, there was very little likelihood that the English would try to reconquer the territory it had lost in Ireland; here there was the measure of shelter from the old imperial power already noted. Curiously enough, the greater vulnerability felt by the Finns led to greater national unity and political and economic institution-building. This discovery deserves a section to itself for the simplest of reasons: it contains the basic theoretical insight of the book.

The Paradox of Vulnerability

Two daily expressions allow us to explain the discovery with which the previous section ended: "necessity is the mother of invention" and "whatever does not kill you makes you stronger." That said, it is often forgotten that not every necessity leads to invention while some challenges do indeed kill. But the basic insight from which we start is that small nation-states do tend to rise to the challenge of the vulnerabilities that they face so as to become inventive and stronger.[11] This is our fundamental theoretical contribution, the paradox of vulnerability that gives this book its title. Consideration of the literatures on small states and on nationalism can explain what is involved.

Peter Katzenstein's contribution to the literature on small states is foundational. His central argument is that many small democratic countries, despite their lack of much natural advantage, were quite successful economically after the Second World War. He explains this in terms of their capacity to react to extreme vulnerability. The Great Depression and Second World War created a feeling of vulnerability for all states, but especially for small ones faced with the possibility of disappearing from the map. According to Katzenstein, small size bred the political ability to respond successfully to such feelings because all interested parties could be gathered around a single table to discuss problems associated with vulnerability and devise solutions for them. The ability of leaders to meet and draw upon these perceptions of vulnerability facilitated the development of an ideology of social partnership—a willingness to work together for the common good—and in turn helped produce much policy learning, cooperation, and flexible adjustment to the various challenges they recognized. Successful economic performance in the postwar period resulted. What mattered most was the capacity to coordinate: to limit internal conflict, to plot and plan, and to cope with international vulnerabilities by designing institutions and policies with which to contend with international forces beyond their control. This leads Katzenstein to appreciate corporatist institutions in small states. Corporatism, he argues, provided great capacities for learning and flexibility because it involved three things: a centralized and concentrated system of interest groups; voluntary coordination of conflicting objectives through continuous political bargaining among these groups, state bureaucracies, and political parties; and an ideology of social partnership expressed at the national level.[12]

Comparative political economists have written a great deal about the first two points, but have tended to ignore the third. For Katzenstein, small states

11 Of course, there are exceptions, such as East and Central Europe during the Cold War period.

12 Katzenstein 1984, pp. 26–30; 1985, chap. 1.

are successful in part to the extent that they can muster an ideology of social partnership and use it to help bring key actors to the bargaining table, coordinate negotiations, and reach consensus among these actors. He also shows that the ideology of social partnership and the institutions embodying it permeate all levels of society—national, regional, and local—and operate across industries. Swiss consociationalism is his paradigmatic case.[13] But where does such an ideology come from? To answer this question we turn to the national question, beginning by drawing on the work of Ernest Gellner not only for his understanding of the origins of national identity but also for his understanding of its consequences.

One can get at Gellner's contribution by noting simply that a common language is a useful resource for a modern society, not least as it allows those who sit down at the table specified by Katzenstein to understand each other, to communicate effectively and easily. Gellner claims that an industrial society is likely to be most successful when a common national culture is present.[14] He stresses homogeneity: each state should have its own nation, and each nation its own state. Societies that are deeply divided culturally often cannot cooperate and, thus, cannot coordinate policy because the different sides want different things. In contrast, the mobilization required for a coordinated response to vulnerability—that is, the willingness to sacrifice for the sake of the nation—often results from the sort of strong national identity found among people with a common culture. Gellner insists that rigid status barriers, such as ethnic, linguistic, or religious differences, that prevented occupational and social mobility in preindustrial times have to be reduced in order to facilitate economic flexibility upon which industrialization and socioeconomic development depend. Central to the reduction of these barriers, he believes, was the rise of state-supported mass education and the widespread cultivation of human capital. This was because a common educational background and elevated human capital enhanced the capacities for people to learn and respond flexibly to a wide variety of challenges. We would add that facilitating mobility and the formation of human capital in this way also has helped spur the development of a particular institutional form—Weberian-style bureaucracy where recruitment and advancement are based on merit and expertise rather than on patronage and clientelism, an important point to which we shall return.

But nationalist studies have gone beyond Gellner's position. Not every nominal ethnic difference leads to nationalist mobilization.[15] What really mat-

13 Katzenstein 1984.

14 Gellner 1983, chap. 3.

15 Gellner 1983, p. 7. See also Habyarimana et al. (2009), McGarry and O'Leary (1993), Min et al. (2010), and O'Leary (2001, 2003).

ters is not whether people have different cultural attributes per se but whether these attributes prevent some from enjoying the same rights as others. As was true of vulnerability, citizens do not always perceive nominal differences as being salient—that is, substantively meaningful—and they may accordingly not have important effects on political or economic performance. For instance, a country may have many ethnic groups, but if institutional arrangements are such that they are all included in political decision-making, then the possibility that divisive ethnic conflicts will materialize may be substantially diminished.[16] This is the Swiss case, a multi-ethnic nation-state. A deep and widely shared sense of national identity is present in Switzerland, a complex country in which people are blessed with multiple identities while also possessing a strong sense of national solidarity.[17] We can underline this point by invoking Benedict Anderson's notion of an imagined community: the term neatly fits Switzerland.[18] What matters is how people perceive the similarities and differences about which Gellner writes; whether they imagine themselves as having things in common with each other or not. Given this crucial caveat about perception, cultural unity is likely to matter in the ways that Gellner suggests. But it is equally important to note that a culturally homogeneous population can be divided politically. This has been true at times in Ireland, where the character of national identity has been deeply contested. The point, then, is that in order for a country to develop a strong sense of national solidarity it must first develop perceptions of a national identity (a sense of "we-ness") upon which solidarity can be based.

A strong national identity can have two types of effects, one is obvious, the other more subtle. The obvious one involves the presence of behavior: a visible willingness to gird the loins and withstand pain to preserve and protect the nation, such as citizens often do when their nation is at war. The subtle one involves the absence of behavior: the limiting of conflict because people take much for granted. In particular, Gellner argues that class conflict inside a common culture is relatively mild if, as noted, it is not conjoined with ethnic, linguistic, religious, or other forms of nationalist conflict.[19] Both of these effects ease—but do not eliminate—conflict and, therefore, facilitate cooperation, sacrifice, flexibility, and concerted state action in the national interest.

If we blend the insights from the literatures on small states and on nationalism we can construct an ideal-typical causal model about small nation-states

16 Posner 2004, 2005. Another factor that may mute ethnic conflict is the social construction of ethnicity itself—that is, whether people of nominally distinct ethnic groups consider themselves to be different from each other or not.

17 Wimmer 2011, 2012.

18 Anderson 1983.

19 Gellner 1983, chap. 7; see also Dahrendorf (1959, chap. 6).

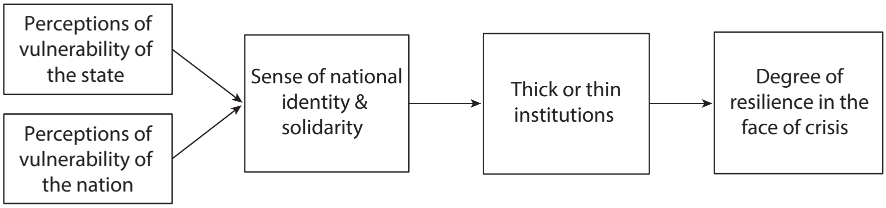

FIGURE 1.1. The Paradox of Vulnerability

represented in figure 1.1.[20] All countries face pressures and try to respond, but small ones perceive vulnerability most powerfully and often respond effectively, especially if they possess deep and widely shared national identities. We stress the following causal patterns. Perceived state vulnerability leads to an ideology of social partnership—that is, a sense of national solidarity—that contributes to the building of thick institutions that facilitate cooperation, sacrifice, flexibility, and concerted state action in the national interest. The result is resilience—the ability of countries to adapt effectively to new situations and challenges when they arise. Similarly, perceived national vulnerability facilitates a sense of national identity (a sense of "we-ness") especially when the nation is culturally homogeneous in terms of religion, language, and ethnicity, which may evolve into a sense of national solidarity. This too facilitates building thick institutions that lead to resilient outcomes. The creation of thicker institutions tends to benefit socioeconomic performance, particularly in today's fast-paced global economy.

Our notion of national identity and solidarity resembles what others have called social capital—a sense of reciprocity and trust.[21] Similarly, our notion of institutions is based on our understanding of Katzenstein but is similar to what historical institutionalists have in mind when they talk about the rules, norms, and compliance procedures that organize political economies, particularly through the administrative apparatus of the state.[22] One could rephrase our argument, then, and say that it blends an analysis of social capital and an analysis of administrative capital into a nation-state–building framework that

20 As noted earlier, it came to our attention shortly before finishing this book that Kindleberger (1951) made a very similar argument decades ago. He argued with particular reference to Denmark's response to changing international wheat markets in the late nineteenth century that small nation-states need to adapt flexibly to shifting international conditions, and develop the institutions to do so in ways that are influenced by nationalist feelings of social cohesion that emerge in response to economic vulnerability. Our argument differs from his by more clearly separating the vulnerabilities of the nation from that of the state, and stressing the difference between objective conditions of vulnerability and subjective perceptions of vulnerability.

21 Putnam and Goss 2002.

22 Hall 1986, chap. 1. See also Evans et al. (1985) and Thelen and Steinmo (1992).

explains the conditions under which some countries are more resilient in the face of crisis than others.

Remember that this is only an ideal-typical model. In real historical cases the manner in which these processes play out may vary in complicated ways. That is why this book is based on detailed case studies; we are searching for the causal processes linking the variables specified in this model.[23] Note too that our model is most applicable to independent countries rather than to those dominated or occupied by foreign powers that are able to stifle the sort of institution-building we have described even when the local population may perceive the need for it. As we will see, this is an important reason why Irish institutions were thinner than those in Denmark and Switzerland.

The three cases are presented in the next chapters, and then summarized and compared in the final chapter. We encourage readers to refer to table 5.1 in the last chapter as they read the case studies in order to see how the cases either conform to or deviate from our ideal-typical model. They will see that while the basic elements of this model explain much of what happens in every one of our countries, each case adds a bit of nuance and complexity to the basic model. The point is that there is nothing automatic about anything in the model: it is probabilistic not deterministic, stressing tendencies rather than inevitabilities.[24] It is not our intent to say that small nation-states always function perfectly, as if they were a piece of advanced German engineering. Very much to the contrary, we recognize that they can go off the rails in various ways, as will become especially clear when we discuss Greece and Iceland in the final chapter. Our precise claim is that those blessed with strong national identities often have the institutions with which to self-correct quickly and flexibly. Furthermore, their ability to cope may continue to be influenced to a degree by their vulnerability to external factors, such as a powerful neighbor or the Eurozone. Nevertheless, our claim is that of resilience over the long run, the ability to create, maintain, and adapt to external vulnerability and danger.[25]

By the same token, it is not our intent to deny enormous difficulties that arise when confronting vulnerability. How could we? All three cases that will

23 Bennett and Checkel 2015a, p. 12.

24 Lieberson and Lynn 2002.

25 Our view of resilience differs from the meaning that some comparative political economists have adopted. Vivien Schmidt and Marc Thatcher (2013), for instance, have used the term to explain why neoliberalism continues to be accepted more or less without question as the appropriate approach to economic policymaking despite abundant proof that it is both logically flawed and empirically wrong. See also Blyth (2013), Crouch (2011), and Hall and Lamont (2013). In contrast, our notion of resilience refers to the ability of small nation-states to respond flexibly and effectively to new challenges that confront them. Resilience for us refers to adaptability rather than persistence. In this sense our notion resembles Taleb's (2012) concept of anti-fragility—that is, the ability of a social system not just to survive shock but also to adjust so as to prosper in new ways.

concern us suffered from civil war! Denmark makes the case with great power. Vulnerability in the face of German unification during the nineteenth century led to nationalist pressures in Copenhagen that played a large part in war with Germany—war that led to the loss of a third of Denmark's territory! Crucially, the ideal-typical model faces challenges to do with immigration that may yet, as we emphasize in the conclusion, destroy it. Put differently, for a country to be closer to the model does not mean that it is ideal in a normative sense. Matters are more complex, life hard; advantages in one area can cause problems elsewhere, while a source of strength at one moment of time can turn into weakness in different circumstances. There is an additional reason why we do not take a Panglossian view of small nation-states: the propensity to engage in groupthink from time to time will be evident in later chapters.

Our earlier statistical analyses suggested that there is much to be said for this model. From the mid-1980s up until the 2008 financial crisis, countries in the OECD tended to experience stronger economic performance if they were culturally homogeneous and vulnerable to the vicissitudes of international trade.[26] This book starts where these earlier analyses ended, and it concentrates on cases rather than on statistics. This allows us to stress diversity among different countries, something that has always mattered not least because vulnerabilities vary, as noted, for particular countries. This matters enormously in terms of the claims that can be made; we are in a position to correct and add to the claims made by small state theory, and to subtly modify Gellner's view of nationalism.

Let us orient readers by hinting at some of our findings. Denmark comes closest to the ideal-typical model. This small and homogeneous nation-state has been blessed with a strong national identity and thick institutions thanks to a long history of geopolitical and economic vulnerability, which has been clearly perceived by Danish elites since the late nineteenth century. This stands at the back of economic and social success. Switzerland demands, as already noted, the modification of Gellner's work. The alpine country contains different languages and religions, but it is clearly an exemplar of prosperity. The different ethnicities live under a single political roof thanks to an institutional frame that is sophisticated and politically inclusive. But the modification is subtle. Switzerland is a multi-ethnic nation-state, in the end corresponding to the insights at the heart of Gellner's view of nationalism because it does possess a strong, fully developed national identity. This identity derived from perceiving vulnerability and then forging institutions that gave all cultural groups real political voice.

Ireland's social formation is less settled. It is a younger country, necessarily lacking institutional development while part of the British Empire. Here the importance of a country's independence or lack thereof becomes clear. It

26 Patsiurko et al. 2012, 2013.

behooves us to listen to Irish voices on the national question. The first is Bernard Shaw noting before Irish independence that

> [a] healthy nation is as unconscious of its nationality as a healthy man of his bones. . . . But if you break a nation's nationality it will think of nothing else but getting it set again. It will listen to no reformer, to no philosopher, to no preacher, until the demand of the Nationalist is granted.[27]

Thus, when nationalism is buried and consensual—that is, when nation-building has taken place—it can help nation-states cope with the challenges of vulnerability. But if nationalism is closer to the surface and contested, it can have such nasty consequences as political division, acrimony, corruption, and sometimes violence. This is a brilliant observation. On the one hand, Denmark and Switzerland prosper in part because their national identity has long been settled and taken for granted. On the other hand, as Shaw helps us understand, nationalist quarrels ensured the end of British dominance and the creation of a new nation-state. However, what is especially important for our account is that even after independence Ireland was for a while sheltered by Britain from the outside world and, as a result, not as vulnerable to geopolitical threats as Denmark or Switzerland or as vulnerable as Finland after its own independence. This meant that in Ireland national quarrels did not have to be quickly forgotten. This led to the dominance of a single political party and hence to thin institutions, notably clientelist practices, with the result that Ireland remained poor for a whole generation. As W. B. Yeats observed, "great hatred" with "little room" did much to "maim us at the start."[28] But once British protection ceased, vulnerability eventually became so pressing that it could no longer be ignored, old nationalist divisions were transcended, and at least some institutional thickening ensued before the financial crisis hit. The nature of the Irish case can be summarized very simply: it is mixed in the sense that the nature of vulnerability and nationalism shifted significantly over time. Its institutions were thinner than those in the Danish and Swiss cases because it faced less pressure and achieved independence much later. Consequently, its response to the financial crisis was rather weak. It is crucial to realize that the variability in the Irish case lends powerful support to the argument of this book.

Institutions, Thick and Thin

Let us explain the distinction between thick and thin institutions that lies behind the findings just noted. Institutions are formal and informal rules, including monitoring and enforcement mechanisms, and systems of meaning,

27 Shaw 1907, pp. xxxiv–xxxv.

28 Yeats 1933.

including identities that define the context within which individuals and organizations operate and interact with each other.[29] States contain institutions including constitutions, electoral systems and bureaucratic procedures that facilitate political decision-making. Nations rest on cultural and educational institutions that facilitate identity formation and solidarity. Institutions need not be static, partly because they are often ambiguous and subject to interpretation; partly because they are settlements forged through struggle, bargaining, compromise, and brute force; and partly because people often try to change them as circumstances change. There is considerable research showing that one such circumstance is the onset of a major economic crisis—a finding corroborated by our case studies.[30] These points must be borne in mind throughout the analysis that follows: a thick institutional portfolio is seen here as one that allows for nimbleness and adaptability, that is, for resilience.

Institutions typically operate as sets or configurations; something can be said about both thick and thin sets immediately. Thick institutions are similar to Max Weber's notion of legalistic and professional bureaucracy. They have four important features. First is expertise. Crucially, bureaucrats are recruited on the basis of expertise rather than patronage or clientelism. This is especially important for states so that policy—particularly policy that involves technically complex issues like banking and finance—is influenced by people who are able to judge objectively and in a relatively effective manner the likely effects of policy options.[31] The second element is inclusiveness. States also need transmission belts linking them to society in order for effective policymaking to take place. Civil society must have institutions based on well-organized groups representing group interests capable of engaging in what Richard Samuels calls the "politics of reciprocal consent" with their states.[32] Yet the balance must be right. States must not be so close to organized interests as to be captured by them and succumb to corruption, nor must they be so far removed from these interests as to be cut off from the vital information they can provide. In the words of Peter Evans, states should enjoy "embedded autonomy."[33] The degree of legitimacy is the third factor. When experts and others recruited on the basis of merit are responsible for policymaking, and

29 Campbell 2004, p. 1. Gellner and Anderson have much to say about systems of meaning, in particular the manner in which nationalism is defined, the degree to which it is taken for granted, and whether it is viewed as legitimate. Nationalism is not quite the same thing as an institution. But it is closely related. Any national identity includes rules of behavior associated with it. As Anthony Smith (1991, p. 9) explains, "National identity involves some sense of political community, however tenuous. A political community in turn implies at least some common institutions and a single code of rights and duties for all members of the community."

30 Eichengreen 2008; Gourevitch 1986. For a theoretical discussion, see Campbell (2004) and Fligstein and McAdam (2012).

31 Evans and Rauch 1999.

32 Samuels 1987. See also Berger (1981), Evans (1995), Pedersen (2006), and Streeck (1997).

33 Evans 1995.

when policymaking is inclusive and consensus oriented, then people are apt to view the policymaking process as trustworthy. This is especially so when people believe that policy is oriented toward advancing the country's best interests—something that is most likely to be found in countries with powerfully held notions of common culture and national identity, able in consequence to create ideologies and institutions favoring social partnership. In this sense scholars generally agree that a developed professionally oriented bureaucracy geared toward enforcing sound property rights and the rule of law is necessary to promote prolonged economic growth and social stability.[34] For our purposes, then, legitimacy, trust and consensus are more or less interchangeable terms. The final element is that of the degree of organizational capacity—that is, a well-developed set of rules, procedures, prescriptions, and policy tools established to organize policymaking and implement policy not only in routine situations but also during times of crisis. It stands to reason that older states with longer institution-building histories and more crisis management experience are more likely than newer ones to have these capacities.

The alternative set of thin institutions is wholly different and bears some resemblance to Weber's notion of patrimonialism. To begin with, recruitment is not based on expertise and professionalism but rather on tradition, patronage, or clientelism. Patronage involves the face-to-face exchange of favors, such as a job or zoning variance, between people of different status and power, often so that the patron gains political support and loyalty from the constituent. Clientelism is patronage on a larger scale, often involving the provision of favors through ward bosses, campaign workers, precinct captains, or other intermediaries. Patronage and clientelism are often based on racial, ethnic, or linguistic divisions, such as the ethnic political machines in nineteenth-century American cities. In other words, they are more likely to be found in heterogeneous societies lacking a strong, unified sense of national identity and social partnership. States based on patronage and clientelism provide privileged rather than equal access to the policymaking process for some groups but not others. In turn the absence of both expertise and inclusiveness undermines legitimacy—people do not believe that policymakers are acting in the best interests of the country. Finally, influence peddling and the lack of policymaking expertise often means that the state's organizational capacities are not well developed: policymakers are so absorbed with self-serving rather than nationally oriented purposes that they do not dedicate sufficient resources to sound institution-building—a problem that is especially acute in many corrupt postcolonial states.[35]

34 Barzel 1989; Fukuyama 2014; North 1990; Weiss 1998.

35 Our view is consistent with research on much larger nation-states conducted by Peter Hall and his colleagues, which showed that the ability of countries such as the United States,

Three final points have great importance. First, as noted, a strong sense of national identity and political stability can arise even in countries with significant racial, ethnic or linguistic differences if the institutions are right. This is why nominally heterogeneous societies sometimes perform quite well. Thanks initially to the insights of Arend Lijphart we know that constitutional design can mollify and contain antagonisms between different cultural groups. In consociational systems elites representing different cultural constituencies eschew decision-making by majority and instead seek compromise or amicable agreement. Proportional representation, federalism, and power sharing can help quite as much. Countries such as the Netherlands, Austria and Switzerland are often cited as examples.[36] The conditions under which constitutional innovations emerge and prove to be effective are the subject of much debate. This need not concern us here other than to say that solutions that have been tried have a mixed record of success. There is certainly no guarantee that any arrangement that works for a while will continue to do so. This has become particularly clear in the Netherlands and Belgium as economic and demographic conditions have undermined long-standing consociational compromises.[37]

Second, the institutional terrain of any political economy is uneven. Even in very well-developed countries institutions in some areas are thicker than in other areas. For instance, during the late twentieth and early twenty-first centuries in the United States a relatively thick set of institutions governed the stock market and banking system, but those governing the trading of derivatives in the shadow banking system, which is where the 2008 financial crisis originated, were so thin as to be virtually nonexistent. Institutional unevenness is one reason why all three of our countries suffered financial crises in the first place—parts of their institutional portfolios were thin, particularly in areas responsible for regulating the financial sector, as we will show in later chapters when we briefly discuss the origins of the crisis in each case. But when it came to coping with the crisis Danish and Swiss institutions were

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Britain, France, and Germany to adapt successfully to the economic vulnerabilities associated with the Great Depression and the aftermath of the Second World War depended on their institutions, particularly those that influenced the ability of policymakers to rally around trusted experts from outside as well as inside the state and incorporate their views into policymaking. Those that did so were more resilient in coping with these vulnerabilities thanks to their embrace of what was then the emergent Keynesian economic policy paradigm (Hall 1989). However, our argument significantly expands upon their research by drawing attention as well to the importance of nationalism and national solidarity as a contributor to institutional resilience. This is another reason why our model has implications for nation-states of all sizes.

36 Lijphart 1999. For a review of the vast literature and debates on consociationalism, see Andeweg (2000) and O'Leary (2005).

37 Jones 2008.

thicker than those of Ireland. Hence, as noted, Denmark and Switzerland managed their initial crises more effectively than did Ireland.

Finally, although we are interested in the general institutional development of the state and civil society, and the connections between them in each country, our concentration is on particular actors. Economic expertise, especially in the area of macro-prudential regulation that is concerned with systemic problems in the banking and financial services sectors, mattered enormously. So too did the style of political decision-making, above all the manner in which state regulators, the legislature, the central bank, and stakeholders in civil society were organized and involved in crisis management. We will see that there was variation across countries in the relative thickness or thinness of these institutions, and in the specificities of the organizations themselves. Such variations are summarized in the last chapter in table 5.1.

Cases and Comparisons

Our earlier statistical analyses showed only correlations. These can mislead, as noted, suggesting causal patterns where none exist. Only when we identify underlying causal processes can we be sure that we have a true account of real relationships.[38] Locating the actual processes reduces the risk of lapsing into either erroneous functionalist accounts in which outcomes are explained by their consequences, or spurious accounts that mistake correlations among variables for real causal connections.[39] The latter is an especially thorny problem when we are trying to sort out causal relationships among many variables but have only a relatively small number of cases with which to work, as is the situation here.[40] This is the reason why we have chosen to turn to the examination of particular cases.

Ours is a comparative historical approach, seeking to understand the pattern of institutional development in one country by contrasting it with that in another. Some reflections on what this methodological approach can bring, both in general and for our analysis, can usefully help specify the character of the whole inquiry. A negative consideration comes to mind immediately. One hardly ever finds that cases are similar in all regards, differing only at a single point—thereby allowing for very tight analytic conclusions. But one can try to correct for this difficulty. We do so by focusing on a common crisis. All three of our countries experienced severe banking crises in 2008, each linked to the broader world financial crisis.[41] The countries affected had to scramble

38 Campbell 2004, chap. 3; Hedström and Swedberg 1998; McAdam et al. 2001, p. 30.

39 Elster 1989; Mahoney 2000; Pierson and Skocpol 2000; Sørensen 1998b.

40 Scharpf 1997, p. 16

41 Fligstein and Habinek 2014, p. 653.

quickly—most immediately with packages to rescue banks—to cope or face the very real possibility that their economies would implode in ways not seen since the Great Depression of the 1930s. It is very important to realize that at the time nobody knew how bad things really were, especially because events everywhere were unfolding very fast. Consider just the last two weeks of September 2008. Several big U.S. banks failed and disappeared. Problems metastasized so rapidly worldwide that the U.S. Federal Reserve bolstered bank liquidity by extending (and often soon expanding) swap lines to the European Central Bank and the central banks of such countries as Denmark, Switzerland, Japan, England, Canada, Australia, and Sweden so that they could begin to stabilize their financial systems. The entire Icelandic banking system collapsed. The point is that in autumn of 2008 and early 2009 all three of our countries faced what seemed at that time to be potentially devastating crises that called for immediate action. The situation was unprecedented as clear and definitive road maps out of the crisis were not available.[42] Fear was in the air. To this day people still disagree about what caused the crisis and what should have been done to cope with it.[43]

What interests us most are the processes by which policymakers made decisions when trying to handle the crisis. We used a variety of data sources in developing the case studies that follow, including interviews conducted with politicians, regulators, central bankers, and journalists involved with or intimately familiar with the events in question. Given our interest in process, interviews were especially helpful, because people talked to us about the ways in which policymakers decided to handle the crisis. In this way we were able to piece together the decision-making that transpired at the time and discern whether it was influenced by the key variables that concern us. Further methodological detail is provided in the appendix at the end of this chapter.

The bulk of our data powerfully captures the institutional portfolios that were in place when crisis struck. However, we also engage in historical process tracing—a methodological approach that is necessary for explaining the big, slow-moving causal processes that generated these portfolios in the first place through nation-state building.[44] But why should we worry about these histories at all? Without this history it is impossible to understand where the thin and thick institutions came from that affected the onset and subsequent management of the crisis. These historical sketches will help readers understand why these institutions worked as they did in ways that led to more successful outcomes in Denmark and Switzerland than in Ireland. In particular,

42 Bernanke 2015; Cardiff 2016; Woll 2014. The difficulties of decision-making amid uncertainty are discussed more generally in March (2010) and Borrás and Seabrooke (2015).

43 For a review of these debates, see Davies (2010).

44 Bennett and Checkel 2015b; Pierson 2003; Tilly 1984.

each country's prolonged historical experiences shaped the cognitive frames and other taken-for-granted assumptions that affected decision-making at crucial moments. For example, understanding the development of national identity and solidarity helps explain why Danish and Swiss bankers kept the national interest in the forefront of their minds during the crisis more than did key Irish banks, with one bank deliberately misleading the government. Understanding the origins of corporatist and parliamentary institutions helps explain why Danish policymakers turned more quickly to a wider range of experts during the crisis than did either the Swiss or, especially, the Irish. Understanding Irish state-building in the shadow of former British rule helps explain why policymakers did not seek more assistance from experts when the crisis hit. In short, analysis of the unfolding of the financial crisis and of its management requires analytic sensitivity to events in the past that sowed the seeds for more recent styles of behavior. Nevertheless, our discussion of these histories is necessarily brief and selective. To do otherwise would require that we write a much different—and much longer—book. So for each case we provide a thumbnail sketch of the country's relevant nation-state–building history as it unfolded as a result of peoples' perceptions of its vulnerabilities. These sketches act like bridges linking the distant past to the financial crisis in insightful ways.

Also, these historical sketches reveal the idiosyncratic events that occasionally influenced crisis management, such as the fact that Denmark faced a mini–financial crisis in the late 1980s, developed some institutions in consequence, and thereby found itself better armed than did Ireland in 2008 when the global financial crisis hit. Further, the crises were not identical, and therefore required somewhat different responses. Denmark and Ireland faced the collapse of domestic housing bubbles but Switzerland suffered from poor bank investments in the U.S. subprime mortgage market. Acknowledging these idiosyncrasies returns us to the prior consideration that historical comparisons are rarely as tight as one would wish. Nonetheless, our analytic approach does allow us to say something important about the eventual resilience of all three countries, and to note the dangers that lurk on the horizon of their respective futures.

We can add a little here to what has already been said so as to hint at the arguments to be made. The contrasts between Denmark and Ireland dramatically highlight the variation in responses to the financial crisis. Denmark is small, homogeneous, and blessed with thick institutions that fit our ideal-typical model like a glove. Denmark managed the situation well. Politicians deferred to the experts and eventually passed a series of bank packages that provided a privately funded state-backed guarantee for all troubled banks. It also included the imposition of haircuts (i.e., financial losses) on investors in the troubled banks. Ireland is a harder case for the model. Ireland is also one of the smallest and most culturally homogeneous countries in the OECD, yet it has comparatively thin institutions. It is often called a liberal market economy where there is much less state intervention, corporatism, and consensus-making in policy.[45] Yet in Ireland when the crisis hit, the state stepped in almost immediately and guaranteed all the banks at tremendous expense to the public purse and without demanding any haircuts. The putative costs were so great that a fiscal crisis of the state ensued. This required a massive bailout orchestrated by the ECB, the European Commission, and the International Monetary Fund—the so-called Troika—in order to avoid national bankruptcy! Finally, Switzerland is also a tough case for our model. Though small, it contains different linguistic and religious groups. Yet its nominal heterogeneity did not prevent it from creating a strong national identity that then allowed it to develop a sophisticated system of corporatism, proportional representation, and federalism in which technocrats dominate policymaking. This thick institutional portfolio allowed the financial crisis to be handled with relative ease: state funds quickly bailed out the biggest bank, and two commissions were established to ensure that the proper steps were taken to manage the crisis and to guard against any recurrence. Experts inside and outside the state acted in a highly professional manner, and as in Denmark this generated political consensus for the decisions taken. But let us remember the warning issued earlier about the dynamic nature of history. Despite the successful ways in which Denmark and Switzerland handled their crises compared to Ireland, there are some recent signs of rot in the state of Denmark, and in that of Switzerland too, while Ireland in contrast is not without some elements of real strength. We will explore these differences in the conclusion.

Precursors to the Crisis

Denmark, Ireland, and Switzerland each in their own way were in difficulty by the time the 2008 financial crisis erupted and world credit markets suddenly froze. The root of their vulnerability stemmed to a significant degree from the fact that banks in each one were able for a time to gain access to massive amounts of credit on very easy terms, thanks in large part to the financial maneuvering of some much bigger nation-states. How this happened deserves explanation.

The crisis began in the United States thanks in part to the tidal wave of foreign money that poured into the country helping to push up house prices. In the couple of decades preceding the financial crisis, America's appetite for

45 Ó Riain 2004, 2014.

borrowing money became nearly insatiable as illustrated, for instance, by the federal government's persistence in running budget deficits. In particular, China held over $1.3 trillion of U.S. debt by the time the crisis hit.[46] Furthermore, beginning in the 1970s U.S. financial markets were gradually deregulated.[47] This resulted in consolidation in the financial services industry.[48] But more importantly, deregulation contributed to the availability of cheap credit by enabling the securitization of mortgages and other forms of debt—an activity that turned out to be enormously profitable and financially dangerous. Securitization involved slicing up debt for mortgages, cars, and credit cards, bundling these slices into complex bonds called asset-backed securities or derivatives, and selling them to investors. This had become a multi-trillion dollar business worldwide by the early 2000s.[49] Coupled with money from abroad, the securitization of mortgages helped generate a massive real estate bubble in the United States through the provision of enormous amounts of credit because the originators of mortgages could quickly sell them to banks or brokerage firms for securitization—and, therefore, not worry about whether the people taking out the mortgages in the first place could actually pay them. Suddenly, nearly everybody could get a mortgage as the market for these so-called subprime and Alt-A mortgages grew rapidly—due as well to the shady lending practices of key mortgage companies. Many of these were adjustable rate mortgages with initially low interest rates. Adding fuel to the fire, issuers of these securitized bonds could buy credit default swaps—a kind of insurance policy—that would cover their losses in the event that the bonds failed, which created an additional incentive to ignore the possibility that the mortgages underlying these bonds might be prone to default.[50] Foreign banks jumped into the U.S. market for mortgage-backed securities. Between 2001 and 2007 foreign holdings of these securities jumped nearly 600 percent to over $1.2 trillion.[51]

Events outside the United States, particularly in Europe, also made credit easier to obtain. First, thanks to skyrocketing oil prices the world was awash in petrodollars after the 1970s, especially from the Middle East. Holders of petrodollars were eager to invest them in the West thus providing a growing source of easy credit for those who wanted it.[52] Second, Germany's postwar success in export markets elevated its savings rate, which enabled it to invest

46 Bernanke 2015, pp. 91–92; Campbell and Hall 2015, p. 105.

47 Davis 2009.

48 FDIC 2005.

49 Fligstein and Habinek 2014, pp. 641–42.

50 Campbell 2011.

51 Fligstein and Habinek 2014, p. 642; BIS 2008, p. 118; Morgan 2008.

52 Kapstein 1994; Simmons 1999.

increasingly abroad. In 2007 German foreign direct investment abroad was about $91 billion, highest among the Eurozone countries.[53] Its portfolio investment abroad in foreign securities and derivatives, specifically bonds and notes, in December of that year was roughly $130 billion.[54] Third, by joining the Eurozone countries with weak credit profiles, like Ireland and Greece, suddenly found instant access to cheap credit. Germany was one of the strongest economies in Europe when the euro was first introduced and, as a result, had one of the lowest debt yields on its government bonds of all the other members.[55] Throughout the 1990s yields on ten-year government bonds, which at first varied widely among European countries, began to converge toward the low German rate. This meant that the other countries were effectively endowed with Germany's very favorable credit rating. Ireland, for example, had much higher yields on its bonds than Germany before it was announced that it would join the Eurozone, but once the announcement was made those yields fell nearly as low as those paid by Germany. It was assumed that the ECB would back all outstanding government debt regardless of the country issuing it. After all, everyone was now using the same currency.[56] Finally, European interest rates were low thanks to ECB monetary policy.

The upshot of all this was twofold. On the one hand, banks were able to borrow increasingly on international capital markets to finance deposit deficits, leverage lending, and make other investments.[57] The abundance of credit helped pump up housing bubbles in European countries like Denmark and Ireland as well as the United States. In part as a result, by early 2010 Eurozone banks had a collective exposure in Ireland of $402 billion.[58] On the other hand, securitization put European banks, such as UBS and Credit Suisse, at risk as they invested heavily in U.S. mortgage-backed securities and often borrowed heavily in order to do so.[59]

All of this seemed to work. But in 2007 interest rates in the United States began to rise, which suddenly made it difficult for those with adjustable rate subprime and Alt-A mortgages to make their monthly payments. People rapidly began to default on their mortgages, and the U.S. real estate bubble began

53 Indexmundi 2013.

54 Deutsche Bundesbank 2013.

55 The "yield" is the difference between what someone pays for the bond and what they receive when it is redeemed at maturity. Low yields indicate low risk of default.

56 Blyth 2013, chap. 3.

57 Ministry of Business and Growth 2013, p. 7.

58 Blyth 2013, chap. 3.

59 Blyth 2013, p. 85. Irish and Swiss banks ranked first and eighth, respectively, worldwide as holding the most U.S. mortgage-backed securities. Swiss and Danish banks ranked seventh and ninth, respectively, as those holding the most U.S. asset-backed commercial paper (Fligstein and Habinek 2014, p. 648).

to collapse.[60] Banks and mortgage companies were suddenly in serious financial distress. Countrywide Financial, an enormous mortgage firm, went bankrupt. Bear Stearns, a large Wall Street investment bank heavily invested in subprime mortgage securities, nearly collapsed but was purchased by J.P. Morgan after much arm-twisting and financing from the U.S. Treasury. Lehman Brothers, another big Wall Street bank with large holdings in securitized mortgages, filed for bankruptcy on September 15, 2008, when the government refused to bail it out. The government feared that covering the losses of Lehman's investors would send a terrible signal to the financial markets that people would not be held accountable for their bad decisions and thereby create incentives for more bad behavior in the future, the "moral hazard" so feared by economists. At this point American International Group, one of the world's largest providers of insurance including credit default swaps, was faced with enormous liabilities and had to be saved by the government, which effectively nationalized it in order to cover its liabilities—but not before panic gripped the entire financial community. Repeated iterations of securitization meant that nobody knew who was holding the toxic mortgages. The credit markets froze. Without access to credit, even businesses that were in good financial shape had trouble getting and refinancing loans. The economy plummeted.

The international reverberations were swift and furious. The crisis metastasized to Europe. Housing bubbles in Denmark and Ireland were pricked; in consequence, some very prominent Danish and Irish banks that had invested in these real estate markets faced disaster. So did UBS and Credit Suisse, which had invested in U.S. mortgage-backed securities and suddenly faced enormous liabilities, perhaps leading to bankruptcy. Trouble was felt across the continent. By mid-2009 the United States and Europe were in the grips of the Great Recession—the worst economic calamity since the 1930s. In many countries unemployment soared, economic growth slumped badly, many people were unable to afford their mortgage payments and lost their homes, and personal savings were seriously depleted if not obliterated entirely. In response, many European countries heeded the advice of the ECB and pursued austerity policies in the hope of rectifying the situation. Following neoliberal theory, austerity was based on the idea that the best way to facilitate economic recovery and restore national economic competitiveness was to reduce wages, prices, and public spending and to raise taxes. In theory this would allow governments to cut their budgets, deficits, and debts. Business confidence would rebound, job-creating investment would pick up, and all would be well again. Such hopes have yet to materialize.[61]

60 Bernanke 2015, p. 165.
61 Blyth 2013.

Conclusion

Let us be clear about the scope conditions of our argument. First, as noted, our model is most applicable to independent nation-states rather than to nations controlled by an imperial power. Second, our claims, like those of Katzenstein, are specific to advanced capitalist democracies in Europe. In particular, while small size can lead to patronage, clientelism, and other forms of corruption that may undermine socioeconomic performance, this usually only happens in less advanced societies with little democracy, where political processes are not especially transparent.[62] Third, we recognize that the survival strategies of small nation-states vary according to the condition of the world political economy within which they have to live. The widespread protectionism of the 1930s was disastrous for these countries, which have ever since argued for free trade regimes. Fourth, the institutional benefits associated with a history of nation-state vulnerability are likely to be greater the more unpredictable the world gets due to growing international trade, capital mobility, and market volatility. In this regard, countries with such histories are lucky insofar as their historical efforts to develop institutions for coping with vulnerability happen to be particularly well suited for today's global economy.[63] In this regard the key variables with which we are working, especially the various dimensions of thick and thin institutions, are increasingly relevant nowadays for all countries regardless of size. Finally, and so crucial as to bear repeating, we fully understand that cultural homogeneity is a very tricky variable. All sorts of differences can be passively present in a society. What matters is the degree to which inhabitants of a nation-state perceive that their differences are salient politically.[64] Nonetheless, culturally homogenous nation-states are more likely, all else being equal, to develop the strong sense of national identity and ideology of social partnership with which we are concerned and in turn cultivate thick institutions than are culturally heterogeneous nation-states. It goes without saying that what also matters is the degree to which inhabitants of a nation-state perceive vulnerability.

We are not arguing, however, that culturally homogeneous countries have all the advantages that result in successful socioeconomic performance. Nor are we arguing that culturally heterogeneous countries are doomed to failure. There is not always one best or most effective route to resilience and success.[65]

62 Kang 2002.

63 Schwartz 2001. The advantage that large countries enjoy of having large domestic markets withers away with economic globalization as all countries share the same world markets (Alesina and Spolaore 2003).

64 Posner 2004, 2005.

65 Alesina and Spolaore 2003; Bennett and Checkel 2015a, pp. 19–21; Hall and Soskice 2001; Hollingsworth and Streeck 1994; Kenworthy 2008.

But we do maintain that national solidarity, whether based on cultural homogeneity or on institutional design able to counter cultural heterogeneity, is an important advantage that has been neglected for too long in the comparative political economy literature.[66] It is this that helped Denmark to right the ship of state when hit by the squall of financial crisis. Still, these considerations bring us back to the absolutely crucial warning issued at the end of the preface: we abhor every sort of ethnic cleansing, and are most certainly not calling for and indeed condemn all such actions.

Appendix: A Note on Method

Data for this project come principally from four sources: documents, including government reports; official online data sources, such as those from the OECD; secondary literature and histories; and interviews with policymakers, central bankers, regulators, academic experts, and others knowledgeable about the cases we studied. We selected people for interviews based on the recommendations of experts on the political economies of each country. We conducted thirteen interviews in Denmark in April 2012, fourteen interviews in Ireland in June 2013, and fifteen interviews in Switzerland in May 2014. Each interview was conducted following the same set of open-ended semi-structured questions but varied somewhat depending on what we had learned in previous interviews. The interviews averaged seventy-two minutes in length. Nearly all were recorded digitally and transcribed professionally. We coded them using Atlas.ti (version 7) using two coding schemes—one deductive and one inductive.[67] The purpose of coding was simply to expedite data retrieval later on.

Our concern is with tracing the causal processes linking a series of variables. This is why the close historical examination of a few cases is of social scientific value. In this regard, process tracing is "the analysis of evidence on processes, sequences, and conjunctures of events within a case for the purposes of either developing or testing hypotheses about causal mechanisms that might causally explain the case."[68] The great benefit of this approach is that it avoids a preoccupation with surface phenomena and potentially spurious associations as, for example, in conventional statistical analysis that can cause us to overlook the deeper and more fundamental causes of the phenomenon of interest. Identifying these deeper factors is crucial for understanding big, slow-moving developments in a social formation.[69] This is also

66 The outstanding recent exception to this generalization is Singh (2015).

67 The rationale for developing the two coding schemes is based on Campbell et al. (2013).

68 Bennett and Checkel 2015a, p. 7. Bennett and Checkel (2015b) provide an excellent set of discussions of process tracing.

69 Pierson 2003; Tilly 1984.

a methodological approach particularly well suited for developing and testing new theoretical arguments on a small number of cases.[70]

In order to check the validity of our interpretations of the data and establish the integrity of our case studies, once we had written polished drafts we sent them to everyone we had interviewed in the first place for the respective chapters. We asked them to read them and provide us with whatever comments they wanted, including especially comments on mistakes that might have been made. We were unable to reach everyone we had interviewed initially. Some had moved to other organizations or retired, and some did not respond to our request. But many did respond, and each of them graciously offered comments and suggestions that were helpful. Virtually everyone agreed with our overall descriptions of the cases. Some suggested minor corrections. Nobody raised significant issues or disagreed with the basic story lines. Some told us that they learned new things by reading our material. As a result, we are confident in the validity of our case studies.

70 Rueschemeyer 2003.