

The World of Small States 6

Anne-Marie Brady *Editor*

# Small States and the Changing Global Order

New Zealand Faces the Future

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# Small States and the Changing Global Order

New Zealand Faces the Future

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Earlier versions of many of these book chapters were trialled at a hui (conference) on New Zealand foreign policy at the University of Canterbury in June 2017, which was attended by senior policy analysts, academics, politicians and graduate students; as well as a wānanga (workshop) hosted by Ngāi Tahu at Rāpaki marae in September 2018. Many of the presentations at these events were written up as policy briefs, now available on the website of the SSANSE Project Pop-Up Think Tank. Some of the book’s authors have incorporated findings from their earlier publications in their chapters. Every effort has been made to contact copyright holders for their permission to reprint their materials in this book.

I am very grateful to Anthony L. Smith for his encouragement and support of this book project, including as one of the book chapter authors. I am also grateful to the

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I dedicate this book with love to my husband Z.J. and our children Francesca, Silas and Matteo.

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## Chapter 22

# Small States and the Changing Global Order: What Small State Theory Can Offer New Zealand Foreign Policymaking

Baldur Thorhallsson

Small state studies have taken an interesting route since their foundation in the late 1950s and the 1960s. At first small states were seen as politically and economically vulnerable—barely able to survive in the hostile environment of the Cold War. Small states relied on the willingness of larger states protect them. Survival might come at the cost of sacrificing their autonomy, both in terms of domestic affairs and their foreign policy. In particular, the sustainability of the small developing states was doubted.

In the mid-1980s, an economic boom associated with the increased flow of goods and capital around the globe swept up many small states, which started to be viewed as better equipped to deal with the new international economy than larger states. Their administrative and economic flexibility in regards to the rapid changes of the international economy was their key to success. Optimism about small states' ability to economically outperform larger states reached its peak in the first decade of the twenty-first century. Deregulation, free flow of capital, and full participation in the liberal economy became the point of departure for small states across the world. Also, large states were keen to learn from the economic wonders of Asian and European 'small tigers', such as Singapore and Ireland.

However, the economic collapse of a number of small states towards the end of the decade, seen in such cases as Ireland, Iceland, and Greece, forced academics to turn back to the traditional small state literature on weaknesses associated with the small size of states. Today, small state studies are once more raising the question of how small states can compensate for the inherent structural weaknesses related to their small size, such as a limited domestic market and the inevitable fluctuations of a global economy characterized by free flow of capital.

Moreover, world powers have yet again been flexing their muscles and thus making many small states wary of their status in the international system. The

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election of Donald Trump as President of the United States has unleashed uncertainty around the globe. Russian militarization and aggression in Ukraine, Syria and Georgia has negatively affected the prosperity and survival of their smaller neighbouring states, and China's increased assertiveness also makes many of their smaller neighbouring states wary and thus seek external protections provided by other bilateral and multilateral actors. Furthermore, new security threats, such as hybrid warfare, cyber attacks, and climate change-related natural disasters, reassert the importance for small states to align themselves with larger states or join international organisations.

The aim of this chapter is to show what small state literature has to offer policy-makers in small states in their attempt to survive and prosper in an uncertain world. The chapter is divided into three sections in addition to this introduction and the conclusion. First, it starts by examining the development of small state theory. The second section will analyse the importance for small states to compensate for their inbuilt structural weaknesses by facilitating particular domestic and external arrangements. This section will introduce the theory of shelter in order to shed a light on how small states can compensate for their structural weaknesses. Shelter theory claims that small states need political, economic, and societal shelter provided by larger state/s and/or international organisation/s in order to thrive and cope with crises. Third, is an analysis on whether multilateral or bilateral shelter arrangements provide more reliable shelter for small states. This section will examine Iceland's close relations with the United States and the latter's decision to leave the former defenceless, by closing its military base in the country and refuse to provide it with aid during Iceland's 2008 economic crash. Hence, the overall aim of this chapter is to provide a framework on the practical literature, as well as a case study which demonstrates how the policy-makers in small states can evaluate their policy options in the new security and economic environment.

## 22.1 Small State Theory: How Can Small States Survive and Prosper?

The notion of the small state in international relations literature was developed in relation to the decolonization process in the late 1950s and the 1960s. Ever since, three interrelated trends have dominated the directions of small state studies. They have transformed and directed the literature in accordance with the prevailing world order.

First, the overarching size-related question was raised in the first wave of small state studies, and had to do with the ability of new small states to survive and prosper in the new post-colonial world order. Key concepts in the literature were 'vulnerability' and 'lack of capabilities.'<sup>1</sup> Small states were seen as similar to large states in

<sup>1</sup>Fox (1959), Vital (1967) and Keohane (1969).

the international system, though their lack of capabilities as compared with their larger counterparts made them more domestically vulnerable and it limited their ability to both defend their interests and have a say in international affairs.<sup>2</sup> Scholars could not agree on a common definition of what constituted a small state. States with up to 30 million inhabitants were considered to be small when compared to those with a larger number of inhabitants.<sup>3</sup> Population size was seen as restricting the size of their domestic market, military, societal expertise, and administrative capabilities. Small domestic markets rely to a greater extent on imports and exports, and tend to fluctuate more than larger economies. Hence, they are often the first to experience international economic crises and are usually first markets to recover from economic downturns. Small states were also seen as unable to defend themselves from aggressive larger states.<sup>4</sup> Moreover, their lack of expertise and the limited size of their public administrations and foreign service made them less capable of operating internationally than larger states.<sup>5</sup> Accordingly, small states were predominantly characterized as weak states in the international system, both in International Relations literature and in its offspring, Small State Studies.<sup>6</sup>

This size-related focus in the literature was heavily influenced by the international order as dictated by the Cold War. The ability of a small state to protect its sovereignty and survive in a hostile world, which consisted of two competing superpowers, was thrown into doubt. The survival of the small state was based on its ability to either form an alliance with a larger state/s, preferably with either of the superpowers, or adopt neutrality and refuse to take sides in the struggle between the superpowers. A considerable number of small states adopted neutrality with the aim of hiding from the hostile international environment.<sup>7</sup> However, the small state literature seems to have been more optimistic about the ability of the small state to survive in close alignment with a larger state than on its own, where it would rely on the goodwill of world actors to respect its sovereignty, by trusting the international rules and norms concerning neutrality.<sup>8</sup> On the other hand, scholars were in almost unanimous agreement that small states oftentimes had to pay a price for their alignment with a large state, which can be seen in terms of sacrificing foreign and even domestic policy-making autonomy.<sup>9</sup> Increasingly, the international system has given small states the option to either seek protection by a single shelter provider or multilateral regional and international organisations, such as the United Nations, the European Union (EU), NATO, the Association of Southeast Asian Nations (ASEAN), and the Organisation of American States (OAS), and small states have

<sup>2</sup>Waltz (1979), Walt (1987) and Rosenau (1968).

<sup>3</sup>Kuznets (1969), Vital (1967), Armstrong and Read (2000) and Archer and Nugent (2002).

<sup>4</sup>Alesina and Spolaore (2003) and Archer and Nugent (2002).

<sup>5</sup>Vajvainen (1971).

<sup>6</sup>Handel (1981).

<sup>7</sup>See Smed and Wivel (2017).

<sup>8</sup>Keohane (1969).

<sup>9</sup>For instance, see a collection of the small state's literature in, Ingebritsen et al. (2006).

increasingly sought to shield themselves within such forums rather than rely on a single protector.

Second, in the mid-1980s, a new trend in small state studies was initiated by the groundbreaking work of Katzenstein who fundamentally altered the image of the small state as less capable than the large state.<sup>10</sup> He ascribed to the findings that the small state was a more volatile unit in the international system, as compared with large states, but disagreed with existing literature at the time that claimed small states were less competent. He claimed that seven small European states (Sweden, Norway, Denmark, the Netherlands, Belgium, Austria, and Switzerland) were more successful, economically and politically, than their larger neighbouring states. This success was due to the close consultation and cooperation between their governments and labour market organisations, which more or less jointly decided the state's economic policy. These seven small states had developed democratic corporatism in order to deal with their small fluctuating markets. The culture of consensus prevailed in the states (as opposite to majority rule in the large states) and was combined with the development of the comprehensive welfare state. As a result, small states were able to shield themselves from economic hardship and political instability during deep economic downturns which were bound to hit them in a capitalist world.

Katzenstein's work was followed by a slew of studies on small states which described them as politically and economically successful.<sup>11</sup> Nowhere was this more noticeable than in the analyses of small European states, such as Ireland and Iceland, in the first years of the new millennium. The smallness of their domestic markets, public administrations, and policy-making networks was said to make them more flexible than larger states and better capable of dealing with the unpredictable international economy. The Celtic Tiger and the Icelandic 'outvasion' were taken as prime examples of how states, both small and large, should deal with a new economy increasingly characterised by the free flow of capital.<sup>12</sup> Building economic resilience in small states was seen as the key to success (higher economic growth) and the concept of resilience was linked to several elements of good governance, such as macroeconomic stability, market efficiency, labour mobility, bridling market dominance, income distribution, social cohesion, sustainable development, and better environmental management.<sup>13</sup>

Scholars were less concerned with the small state's ability to survive than during the Cold War era, and their focus was almost entirely on the opportunities associated with smallness. Challenges facing small states, which were identified in the original literature (as discussed above), were sidelined. These discussions also led to changes in how small states were defined. Small states were not any longer strictly understood by the traditional variables, such as the size of the population, the economy, the territory, and the administration. Instead, a relational definition shifted the focus

<sup>10</sup>Katzenstein (1985).

<sup>11</sup>Cooper and Shaw (2009) and Briguglio et al. (2008).

<sup>12</sup>For instance, see criticism of the approach in Thorhallsson and Kirby (2012).

<sup>13</sup>Briguglio et al. (2008).

from the defined capacity of the state to the exact activity of the state, operating under the premise that a small state can be volatile in one context, but simultaneously influential in another.<sup>14</sup> Thus, a large state is one that has the ability to affect all policy sectors, such as Germany in the EU.<sup>15</sup> Also, scholars increasingly started to take account of both objective and subjective measures of size.<sup>16</sup> For example, elements such as the view of internal or external actors of the state's capacity were considered important in defining and explaining the state's behavior in the international system. Moreover, domestic actors' ideas, ambitions, and priorities regarding the state's role in the international system were also considered useful in this context and sometimes combined with the traditional variables in order to give a more comprehensive picture of states' size and international behavior.<sup>17</sup> Finally, comparative size is increasingly considered of great importance, meaning that a state can be regarded as large in one context and a small in another.<sup>18</sup> For instance, Tonga is a small state in comparison with New Zealand, while at the same time New Zealand is small in comparison with Australia. Hence, the international relations literature and small state studies has now moved away from an attempt to find a universal definition for what constitutes a small state or placing states in fixed categories based on their size.

Third, the 2008 international financial crisis, which led to massive economic difficulties in several small states around the globe, also shifted the focus in small state studies. The literature continued to make use of the additional variables (as discussed above) in defining the size of states and their international behaviour, but greater attention was given to the traditional variables. The focus shifted from the opportunities related to smallness, to the original findings, which framed the challenges associated with small size. Scholars became obsessed with finding a reason for the collapse of the Celtic Tiger and the Icelandic outvasion.<sup>19</sup> These and other small states economies, which had been hailed as great successes, such as the economies of Greece, Portugal, Estonia, Latvia, and Lithuania, had to be rescued by the EU and the IMF. Scholars disagree on the reasons for their economic failure (such as whether or not membership of the Eurozone had been a good or bad decision for these small states) but they overwhelmingly agree that the small size of their market, the Eurozone's limited capacity to provide a financial backup, and their greater reliance on external assistance compared with larger markets in times of need made them more volatile than larger states.<sup>20</sup> The original findings of the small state literature still contends that '[a] small state is more vulnerable to pressure, more

<sup>14</sup>Mourtizen and Wivel (2005).

<sup>15</sup>Archer et al. (2014).

<sup>16</sup>For example, see Thorhallsson and Wivel (2016).

<sup>17</sup>Thorhallsson (2006) and Magnúsdóttir (2010).

<sup>18</sup>Archer et al. (2014) and Archer and Nugent (2002).

<sup>19</sup>Thorhallsson and Kirby (2012).

<sup>20</sup>Regling and Watson (2010) and Carey (2011).

likely to give way under stress, more limited in respect of the political options open to it, and subject to a tighter connection between domestic and external affairs.<sup>21</sup>

Furthermore, the changing security environment has brought small state studies back to its core concepts and reinforced the importance for small states to form alliances with larger states and/or join multilateral organisations—as demonstrated in this book.<sup>22</sup> The new security environment requires small states to be prepared to deal with new threats such as hybrid warfare, cyber attacks, and climate change-related natural disasters. They also need sufficient means to deal with propaganda campaigns, as well as with the rise of terrorism and the refugee crises. Small states are also faced with the changing foreign policy preferences of some of the leading world powers. China looks increasingly assertive, Russian aggression in Ukraine and Syria has made its smaller neighbouring states extremely worried, the United States is unpredictable under its current leadership, meanwhile Germany no longer hesitates to take the lead in Europe, and Britain's role in Europe and world affairs, in general, is in question due to its decision to leave the EU.

Accordingly, the small state literature has turned its attention back to the questions upon which it was founded: How can small states survive and prosper in an unpredictable and hostile environment? How can small states best deal with both the existing and the new challenges, such as cyber attacks and the free flow of capital? How can small states compensate for their built-in structural weaknesses? The following section will attempt to answer these questions.

## 22.2 The Theory of Shelter: The Cost-Benefit Balance of Alliance Formation

Small states have to compensate for their weaknesses in order to survive and thrive. Small states are unable to overcome their structural weaknesses, such as having fewer inhabitants, smaller domestic markets (and GDP), smaller territory and limited military capacity as compared to larger states. However, small states can compensate for their inbuilt vulnerability by adopting particular domestic and/or external measures.

Firstly, small states can make domestic arrangements in order to prosper. Katzenstein demonstrates how small European states buffered from within by developing democratic corporatism that was built on consensus decision-making.<sup>23</sup> They also adapted domestically to the fluctuating international economy, characterized by a bargaining framework where all important interest groups participate in policy formation and the subsequent implementation of the government's policy, thus creating a comprehensive welfare state, as discussed above. Katzenstein's seven

<sup>21</sup>Vital (1967), p. 77.

<sup>22</sup>Archer et al. (2014).

<sup>23</sup>Katzenstein (1985).

democratic corporatist small states adjusted smoothly (according to real GDP growth rates) to the 2008 international financial crisis. Meanwhile, European non-corporatist small states, such as the Baltic states, Ireland, Iceland, Portugal and Greece were hard-hit by the crisis.<sup>24</sup> Also, good economic management and administrative competence can serve as a domestic cushion to shield small states from a volatile international system.<sup>25</sup> These initiatives proved to be vital in determining how small states were affected by and responded to the 2008 international recession.<sup>26</sup>

Secondly, small states can make external arrangements in order to compensate for their structural weaknesses and form an alliance either with a larger state/s or by joining an international organisation/s. In the post-war period most small states around the globe sought an alliance with either of the superpowers or a large neighbouring states. Those who adopted neutrality could not help but take sides in the Cold War struggle in terms of their trade policy, pursuance of military equipment and societal relations.

In the wake of the latest international depression, in which several small states were hard-hit economically and that resulted in domestic political uproar, such as in Iceland and Greece, a new theory of small states (the theory of shelter) was built.<sup>27</sup> This new theory takes into account the domestic structural weaknesses of small states which were largely ignored by policy makers and academics in the boom years leading up to the crisis. The theory of shelter is also built on the International Relations and small state literature which generally claims that small states are exposed to external challenges.<sup>28</sup>

The importance of shelter is related to three interrelated features: the reduction of risk in the face of a possible crisis event, providing help in absorbing shocks during a crisis situation, and administering assistance in dealing with the aftermath of the crisis. Small states have greater difficulties in dealing with crises on their own as compared to large states.<sup>29</sup> They are 'more likely to give way under stress' as claimed by Vital.<sup>30</sup> Hence, small states need political (including military), economic, and societal shelter provided by larger states or/and multilateral organisations, according to shelter theory.

Political shelter takes the form of direct and visible diplomatic or military backing, as well as other strategic coverage at any given time of need by another state or an international organisation, and/or organisational rules and norms.

<sup>24</sup>Thorhallsson and Kattle (2013) and Thorhallsson and Kirby (2012).

<sup>25</sup>Thorhallsson (2012).

<sup>26</sup>For example, see T. G. Pétursson and T. T. Ólafsson, "Weathering the Financial Storm: The Importance of Fundamentals and Flexibility," Economics Working Paper 2010-2017 (September 2010), [http://www.econ.au.dk/fileadmin/site\\_files/filer\\_oekonomi/Working\\_Papers/Economics/2010/wp10\\_17.pdf](http://www.econ.au.dk/fileadmin/site_files/filer_oekonomi/Working_Papers/Economics/2010/wp10_17.pdf).

<sup>27</sup>Thorhallsson (2010, 2011).

<sup>28</sup>Fox (1959), Keohane (1969) and Rothstein (1968).

<sup>29</sup>Thorhallsson (2010, 2011).

<sup>30</sup>Vital (1967), p. 77.



Economic shelter can take the form of direct economic assistance, a currency union, help from an external financial authority, beneficial loans, favourable market access, a common market, etc., all of which are provided by a more powerful country or by an international organisation.<sup>31</sup> Societal shelter refers to the importance of cultural transactions for small states, in terms of a transfer of messages, norms, lifestyles, ideologies, myths, and ritual systems in order for them to compensate for the lack of expertise in their small communities.<sup>32</sup>

A number of studies on small states indicate that they have received comprehensive shelter provided by larger states and/or international organisations. For instance, the membership of the European Union has provided the Baltic states with political, economic, and societal shelter. Ireland received partial economic shelter provided by its membership in the EU and the Eurozone in relation to the recent economic crisis.<sup>33</sup> For instance, these four states were provided with joint EU-IMF rescue packages in the aftermath of the latest international financial crisis. Also, immediately after the collapse of the Soviet Union, small Central and Eastern European states rushed to seek political shelter (in military terms) provided by membership of NATO, as well as and political (in terms of diplomatic and administrative support), economic, and societal shelter provided by membership of the EU.

Moreover, the alliance choices of Armenia, Cuba, Singapore, and Iceland (see discussions below) have provided the states with shelter.<sup>34</sup> Armenia has sought both strategic Russian shelter against Turkey and Azerbaijan and partial political and economic shelter provided by Western powers and multilateral institutions. Cuba's essential bilateral multi-purpose shelter provided by the Soviet Union collapsed with the end of the Cold War and Cuba successfully sought new shelter providers as diverse as China, Venezuela, and Canada and the multilateral institutionalised regional community. Singapore's shelter solution in the complex environment of East Asia in the post war period was classic: it sought strategic protection from the former colonial power through a Five Power Defence Agreement (signed with the UK, Australia, New Zealand and Malaysia), a less formal protective relationship developed with the US and political and economic shelter from membership of ASEAN. The ASEAN forum not only provides Singapore economic shelter, but it also deals with traditional and non-traditional security challenges', such as terrorism and piracy, and as such enables Singapore to present its views on the East Asian region's security threats. Importantly, none of Singapore's shelter relationships has been so binding as to force internal transformations, rather they have provided a shield for the distinct Singaporean society.<sup>35</sup>

<sup>31</sup>Thorhallsson (2010, 2011).

<sup>32</sup>Thorhallsson (2012). For a historical account on the importance of political, economic, and cultural features in centre-periphery relations see Rokkan and Unwin (1983).

<sup>33</sup>Thorhallsson and Kattle (2013).

<sup>34</sup>Bailes et al. (2016).

<sup>35</sup>Bailes et al. (2016), pp. 20–21; Han (1998).

On the other hand, shelter relations can have costs for the beneficiary. For instance, the EU-IMF rescue packages were provided with strict conditions regarding the states' domestic policies. NATO and EU shelter may carry considerable cost related to the application of their structures and rules.<sup>36</sup> Also, the shelter provider may expect the protected state to follow its foreign policy preferences and have a considerable impact on its domestic policies.<sup>37</sup> Moreover, seeking shelter may also cause domestic rifts within small societies, which can be seen in the deep divisions in Iceland in relation to the country's special relationship with the US during the Cold War.<sup>38</sup>

Finally, shelter theory provides a framework through which to study the costs and benefits associated with a state's political, economic, and societal relations to external actors. The pursuit of shelter, its costs, benefits, or lack thereof, has to be carefully examined by small states' policy-makers. Accordingly, the shelter theory can help to shed a light on New Zealand's bilateral political, economic, and societal relations with larger powers such as China, the USA, Australia, and Britain. It may also help to evaluate the cost-benefit balance for New Zealand to engage in multilateral cooperation, such as the Regional Comprehensive Economic Partnership (RCEP) and the Trans-Pacific Partnership Agreement (TPPA). New Zealand may be provided partial or comprehensive shelter by these states and body but simultaneously, it provides South Pacific small island states shelter in partnership with Australia, the Pacific Island Forum and Quad marine patrols grouping (US, France, Australia, NZ). The choice of a shelter provider will depend on the proportion of benefits to cost.

### 22.3 Multilateralism Versus Bilateralism Shelter Arrangements: The Case of Iceland

An interesting question arises as to whether bilateral or multilateral arrangements provide small states with more reliable shelter. The case of Iceland provides interesting insight into bilateralism as a form of shelter in times of crises.

Iceland—a country without an army—has been searching for shelter ever since the United States closed its military base in 2006, and refused to provide it with a rescue package following the 2008 economic crash. To date, Iceland has not yet secured shelter to the extent it had experienced with the USA—although the bilateral defence agreement with the superpower, (originally signed in 1951 but dating back from 1941) is still in place and the country is a founding member of NATO.

<sup>36</sup>Bailes and Thorhallsson (2013) and Katzenstein (1998).

<sup>37</sup>Thorhallsson and Gunnarsson (2017a).

<sup>38</sup>Baldur Thorhallsson and Sverrir Steinsson, "Small State Foreign Policy," in *Oxford Research Encyclopedia of Politics*, last modified May 2017, <http://oxfordre.com/politics/view/10.1093/acrefore/9780190228637.001.0001/acrefore-9780190228637-e-484>.

A central component of Iceland's political shelter was the American military presence within the small Nordic state. Iceland is geographically placed in the middle of the GIUK-gap, a naval choke point, between the landmasses of Greenland, Iceland, and the United Kingdom. The GIUK-gap became the focus of navel planning of the Western Bloc in order to prevent the Soviet navy from operating freely and taking over the North Atlantic during at a time of war.

Iceland vehemently opposed the United States' intended closure of its military base and never backed down from the steadfast position that US military presence in the country was needed. The Icelandic government tried to make the most out of the remaining US commitments in Iceland, especially after the negotiation reached a deadlock and the US unilaterally decided to close the base.<sup>39</sup>

Until 2006, the US was also deeply involved in the provision of economic shelter to Iceland, as it continued to pay for Iceland's defence, as well as build and run the international airport at Keflavík, the air surveillance system, and other infrastructure. Moreover, until the late 1960s, the US provided Iceland with direct economic assistance—especially in times of economic downturn.<sup>40</sup> Iceland therefore turned to the US for financial assistance when the country was hit by the 2008 international financial crisis, which had caused an almost complete collapse of its financial system. The Icelandic Central Bank approached the US central bank and requested a currency swap agreement, similar to that which the US Federal Reserve had offered Switzerland, the other Nordic countries, and many other countries around the globe.<sup>41</sup> However, in this specific instance the United States declined Iceland's request for financial support.

With their request for financial support denied by the US, Iceland turned to the European Union for assistance. However, the EU also turned down Iceland's request for aid, citing the fact that Iceland was not a member state.<sup>42</sup> Iceland's membership of the European Economic Area (EEA) and Schengen is secondary to formal membership of the Union.

To compensate for diminishing American political and economic shelter, Iceland has sought shelter from alternative sources. The Icelandic government has made civil security agreements—mostly concerning its waters—with the United Kingdom, Denmark, Norway, and Canada. The aim of the agreements is to exchange information, discuss common security concerns, and plan various projects regarding training and military exercises. Furthermore, airspace surveillance arrangements have been

<sup>39</sup>For example, see Baldur Thorhallsson, "A Small State Seeking Shelter: Iceland's Search for Shelter" (conference paper, Small States and the Changing global order: New Zealand Faces the Future, Christchurch, 4 June 2017), <https://www.canterbury.ac.nz/media/documents/research/The-small-state-in-the-new-global-order.pdf>.

<sup>40</sup>Ingimundarson (1966).

<sup>41</sup>U.S. Government Accountability Office, *Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance*, GAO-11-696 (July 2011); Central Bank of Iceland, "Norraænir seðlabankar framlengja gjaldmiðlaskiptasamninga," news release, 20 November 2008, <http://www.seðlabanki.is/?PageID=13&NewsID=1970>.

<sup>42</sup>Thorhallsson and Kirby (2012).

made with various NATO member states, including France, Germany, and the UK, and the non-NATO Nordic states of Sweden and Finland, that allow for the temporary presence of their jet fighters in the country.<sup>43</sup>

Alongside its pursuit of new bilateral agreements, Iceland has sought to strengthen its ties with NATO in an effort to shore up the organisation's provision of shelter to the country. Central to achieving this is its participation in the NATO Infrastructure Fund, as well as remaining committed to its international operations. The release of the country's first ever defence budget, as well as the offer to cover all substantial costs for military exercises in the region, further emphasises that Iceland is increasing its own contribution in an effort to retain its political shelter.<sup>44</sup>

In addition to its pursuit of political shelter, Iceland has begun to consider new avenues for economic shelter. In 2009, just nine months after its economic crash, Iceland applied for membership of the European Union. The collapse gave the pro-European Social Democratic Alliance (SDA) a brief opportunity to place the EU question on the political agenda. The SDA mainly focused on the potential economic benefits of EU membership and the adoption of the euro, emphasizing the benefits of cheaper goods for consumers and enterprises, and access to aid from the EU structural funds for rural areas, agriculture and the tourism industry.<sup>45</sup> There was, however, no mention of the EU as a soft security shelter provider.<sup>46</sup> After a speedy economic recovery and considerable domestic opposition to membership, the application was put on hold in 2013. At present, the Icelandic government does not regard the country as a candidate country to join the EU—though it has not withdrawn the membership application.

Icelandic politicians have also looked to non-traditional sources for support—namely China and Russia. In 2010, the Icelandic Central Bank and the Central Bank of China made a currency swap agreement. The agreement may not have been of much financial importance, but it increased Iceland's much needed credibility at the time and was a statement of trust. This agreement was renewed in 2013 and in 2016. Moreover, China always supported Iceland's attempt to get a rescue package from the IMF at the same time Iceland's European allies blocked the IMF assistance to Iceland for over a year. The blockage was related the so-called Ice-save dispute between Iceland on the one hand and Britain and the Netherlands on the other who demanded the Icelandic government would fully compensate their citizens who lost their savings in the fallen Icelandic banks. China took a deliberate decision to help Iceland at the time of the crash, according to the Chinese Prime Minister. These events have led to close cooperation between the countries, according to the former President of Iceland.<sup>47</sup> Iceland was the first European country to sign a Free Trade Agreement with China, which entered into force in 2014. It covers trade in goods

<sup>43</sup>Thorhallsson, "A Small State Seeking Shelter."

<sup>44</sup>Thorhallsson, "A Small State Seeking Shelter."

<sup>45</sup>Thorhallsson and Rebhan (2011).

<sup>46</sup>Bailes and Thorhallsson (2013).

<sup>47</sup>Sjónvarp Símans (2018).

and services, rules of origin, trade facilitation, intellectual property rights, competition, and investment. The free trade agreement also stipulates that the two states should enhance their co-operation in a number of areas, including on labour and environmental issues.<sup>48</sup> Iceland has also signed a number of other cooperation agreements with China, such as those related to the Arctic, oil exploration, and cooperation in the field of marine and polar science.<sup>49</sup>

Furthermore, the former president of Iceland (1996–2016), Ólafur Ragnar Grímsson, enthusiastically campaigned for closer political and economic ties with Russia. He especially emphasised close cooperation with Russia on Arctic issues, and made a special effort to retain friendly ties between the two states following Russia's breach of Ukraine's sovereignty.<sup>50</sup>

At the height of the 2008 economic crash, the Icelandic Central Bank hinted that the Russian Government was willing to bail out Iceland with a substantial loan. The US ambassador in Reykjavik was clearly concerned about this prospect, reporting to Washington that "...the PM asked at the press conference why Iceland shouldn't call on the Russians if they could help?"<sup>51</sup> The ambassador also claimed that the embassy had encouraged the Icelandic government to look for shelter elsewhere other than from Russia: "We doubt that it would be in the interest of the U.S. or NATO for the Icelanders to be beholden to Russia, however "friendly" the loan terms may be."<sup>52</sup> Notably, the ambassador also encouraged Washington to consider stepping in and offering assistance: "The possibility of a Russian loan bailout as well as concerns voiced by some American bankers raise the question of whether greater USG involvement in the crisis is merited."<sup>53</sup> The response from Washington, however, was not positive. The US offered no financial assistance, and Washington officials expressed relief when the Russian government hinted that it was willing to bail out Iceland after the crisis hit.<sup>54</sup> While nothing came to fruition from the Russian loan

<sup>48</sup>Free Trade Agreement between Iceland and China, 15 April 2013, <https://www.mfa.is/foreign-policy/trade/free-trade-agreement-between-iceland-and-china/>.

<sup>49</sup>Iceland Abroad, "China and Iceland Sign Agreements on Geothermal and Geoscience Cooperation and in the Field of Polar Affairs," news release, 23 April 2012, <http://www.iceland.is/iceland-abroad/cn/english/news-and-events/china-and-iceland-sign-agreements-on-geothermal-and-geoscience-cooperation-and-in-the-field-of-polar-affairs/8882>; National Energy Agency, "Orkustofnun Grants a Third Licence in the Dreki Area," news release, 22 January 2014, <http://www.nea.is/the-national-energy-authority/news/nr/1540>; Government of the People's Republic of China & Government of Iceland, "Joint Statement between the Government of the People's Republic of China and the Government of Iceland on Comprehensively Deepening Bilateral Cooperation," 15 April 2013, <https://eng.forsaetisraduneyti.is/media/frettir1/Joint-statement-of-PMs-Iceland-China-2013.pdf>.

<sup>50</sup>For example, S. K. Ólafsson, "Forsetinn setti ofan í við norskan ráðherra," *Visir*, 19 March 2014, <http://www.visir.is/g/2014140318637/forsetinn-setti-ofan-i-vid-adstodarutanrikisradherra-noregs>.

<sup>51</sup>U.S. Embassy Iceland, "Icelandic Economic Crisis, Time for USG to Get Involved?," 8 October 2008, [https://wikileaks.org/plusd/cables/08REYKJAVIK225\\_a.html](https://wikileaks.org/plusd/cables/08REYKJAVIK225_a.html).

<sup>52</sup>U.S. Embassy Iceland, "Icelandic Economic Crisis."

<sup>53</sup>U.S. Embassy Iceland, "Icelandic Economic Crisis."

<sup>54</sup>U.S. Embassy Iceland, Information from a High Ranking Official, May 2009.

offer, the fact remains that Icelandic policy-makers were willing to entertain the possibility of a Russian rescue package.

Most recently, prominent Icelandic politicians have been looking at how a post-Brexit environment may benefit the country. According to the current foreign minister, Brexit—and the associated opportunities it may provide—has now become a priority issue for the Icelandic Ministry for Foreign Affairs. The minister hopes that the UK, as the fifth largest world economy, becomes the leader of free trade in the world after it leaves the EU. This in turn might allow Iceland—as the UK's neighbouring state and established trade partner—to utilize this opportunity and engage in free trade worldwide, thus strengthening its economy.<sup>55</sup> Moreover, in 2019, Iceland and Britain signed an enhanced agreement on security and defence cooperation. The agreement will enhance the countries' security cooperation in new areas such as policing, counter-terrorism, search and rescue, risk and crisis management, and cyber security.<sup>56</sup>

Icelandic policy makers steadfastly believed that the US would not close its military base in the country and leave the country defenceless. Also, they were of the opinion that the US would come to its economic rescue in the period leading to the crash, during the crash and in its aftermath. Hence, they were convinced that the US would provide Iceland with political and economic shelter in times of need. However, in 2006 and 2008, Iceland was no longer regarded as strategically regarded of importance by Washington. They unilaterally closed their military base in the country—despite the 1951 defence agreement's clear commitment that changes to it could only be made through a mutual agreement between the parties—and subsequently left the country defenceless. Also, US authorities made it obvious that Iceland was no longer be provided economic shelter by the superpower—despite Iceland's economic crash. Accordingly, Iceland's bilateral political and economic shelter with the USA was terminated.

On the other hand, Iceland's membership in NATO provided a framework for civil security agreements and airspace surveillance arrangements with various NATO members and the temporary presence of their jet fighters in the country. Moreover, the International Monetary Fund (IMF) came to Iceland's rescue in the end.

At present, Icelandic society is divided on whether to seek multilateral or bilateral shelter. This is demonstrated by Iceland's EU membership application in 2009, the halting of the EU accession process in 2013, and discussions about a possible referendum on whether or not to continue the accession talks. Moreover, the search for partial shelter provided by Russia and China, and now most recently Britain, indicates the dissolution. Furthermore, several Icelandic politicians frequently refer to the existing bilateral defence treaty with the USA in the hope that the superpower will turn back to Iceland and provide it with comprehensive political and economic shelter due the growing importance of the Arctic, especially in regards to the opening

<sup>55</sup>Thorhallsson and Gunnarsson (2017b).

<sup>56</sup>Icelandic government (stjórnarráðið) (2019).

up of the Arctic sea road, the increased Russian military activities in both the Arctic region and in Europe, and China's ever-growing interests in the Arctic.

To summarize, following the events of 2006–2008, Iceland began searching for a replacement form of shelter provided by other external actors. However, it has not yet secured shelter to the extent that it had received from the USA. Icelandic decision-makers need to closely examine to what extent multilateral shelter arrangements (such as NATO and the EU or Schengen and the EEA) may be more reliable providers of shelter in times of need, than that of a single protector, such as the USA or the UK.

## 22.4 Conclusion

Small states need to compensate for their inherent structural weaknesses. Small states may not be able to overcome their vulnerabilities but they can compensate for them by adopting particular domestic and external measures. The aim of this chapter has been to shed a light on how small states can seek shelter provided by external actors in order to shield themselves from the weaknesses associated with their small size. The chapter has also examined the case of Iceland in order to evaluate the cost and benefits associated with shelter provided by an external actor and gauge whether multilateral shelter arrangements might be more reliable than shelter provided by a single protector.

The chapter indicates that scholars and policy-makers must take account of the difference in the sizes of states in each and every case study in their policy-making, otherwise they are in danger of overlooking an important explanatory variable, that of smallness. We also argue that the classic small states literature, with its focus on the importance of securing a protecting power combined with the importance of political, economic, and societal shelter for small states, is highly valid for understanding the status and role of small states in the international system. Accordingly, small states have to either form an alliance with larger states or join multilateral organisations in order to protect themselves.

Policy-makers in a small state, such as New Zealand, must acknowledge limitations related to the size of their state, otherwise they will not make appropriate measures to compensate for them. Warning signs about the state's restraints, such as those regarding the state's ability to defend its banking sector or curb cyber attacks, may simply be overlooked. Policy-makers have to accept that a small state needs political, economic, and societal shelter provided by external actors. Not all small states, however, are willing to live up to that reality.

On the other hand, small states have to evaluate the shelter's costs and benefits before moving into shelter relations. There are costs associated with shelter and these costs can be severe. Policy-makers in small states have to answer critical questions, such as whether or not they want to be fully or partly sheltered by a single shelter provider, such as the USA, China, or Russia. The small state has to consider what implications the shelter relations may have on its domestic affairs, such as

democracy and human rights, and culture and society, in general. At present, Russia and China may provide some small states important shelter in terms of economic benefits but these states' authoritarian rule does not make them appealing shelter providers to small states. They are at least not ideal partners for small democratic states seeking political shelter, where governance is based on the rule of law and respect for human rights. Policy-makers in New Zealand must carefully consider whether China is an attractive ally for them, especially weighing the evidence of its lack of respect for democracy and human rights, and its interference in New Zealand's domestic affairs.<sup>57</sup> The choice of a shelter provider may also be costly in terms of the small state's ability to prioritize its foreign policy objectives, for example, New Zealand's much vaunted 'moral leadership' in world affairs.<sup>58</sup>

The case of Iceland, and the experience of small EU member states, indicates that a protection by a single power is less reliable than shelter provided by a multilateral framework. A small state in a need of shelter must be aware of the fact that the shelter provider may not be willing to help in a time of crisis and may even partially or fully withdraw its support. Iceland and New Zealand have both experienced such scenarios. Accordingly, the US desertion of Iceland in 2008 and cutting off ANZUS ties with New Zealand in 1985 illustrates the risk associated with a small state's dependence on shelter provided by a single shelter provider. The traditional International Relations literature underestimates the role of multilateral organisations, such as the EU and forums such as ASEAN and RCEP, in providing political and economic shelter to small states. Benefits of close encounters between small states and multilateral organisations may not be as noticeable as the advantages of close shelter relations with a large state. For instance, the benefits that Iceland derived from the political and economic shelter provided by the US were more conspicuous, and received much greater attention than the shelter provided as a result of Nordic cooperation and membership of NATO, and partial participation in the European project. Multilateral forums share and spread risk and members often operate according to set rules based on mutual assistance to other members in times of need. Accordingly, international organisations or fora bind larger states to helping out their smaller partners. Large states will have greater difficulties backing down from their commitments to multilateral organisations than to individual states as defined by bilateral relations. Hence, small state's policy-makers must take into account the pros and cons of bilateral and multilateral shelter arrangements.

The changing global order has opened up the possibility for many small states to choose their shelter provider. They may seek shelter from a single protector, be it a large state, world power, or an international institution/s. But whatever they choose, policy-makers in small states should carefully manage their relations with world powers, such as the United States, Russia and China, in order not to jeopardize their sovereignty and prevent the shelter relations turning into a trap.

<sup>57</sup>Brady (2017).

<sup>58</sup>Henderson (1991).

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