

## *Does country size matter for public sector size?*

Note that with an increasing degree of publicness, the costs of in-house production and outsourced production combined with public provision should converge for most provision arrangements, because the burden of the diseconomies of scale effect has to be borne by somebody, which is the public in most cases.<sup>31</sup> We therefore refrain from distinguishing between different organizational possibilities in connection with the provision of goods and will simply refer to «production» or to «provision» in Chapter 3.

In this chapter, the empirical results of Alesina and Wacziarg, which are primarily based on data for the first half of the 80ies, can be confirmed, in principal, also for the 90ies. Smaller countries have higher public expenditure<sup>32</sup> relative to GDP than larger ones. Notwithstanding, a closer inspection in this study shows that the connection between government size and country size is somewhat murky and it hinges on the choice of proxy for country size. When GDP or GNP is used instead of the number of inhabitants, country size seems unrelated to public expenditure. This finding is not in line with that of Alesina and Wacziarg, because they assign significance to both measures of country size.

Furthermore, this chapter is designed to examine the dynamics of the relationship between government size and country size. Considering the development of international and regional organizations (like the European Union) in providing international, global or regional public goods during the last decades, the influence of country size on public expenditure should have decreased significantly. This should especially hold true for countries with good bilateral relationships to their neighbors because of the many public goods that can be provided across borders.

Section 3.1 provides a simple theoretical model displaying the relationship between government size and country size. It also summarizes the impact of other important determinants which are not part of the model. In Section 3.2, the data base is described and empirical evidence is presented. Finally, Section 3.3 briefly concludes by trying to explain the results and by discussing a few shortcomings.

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<sup>31</sup> A notable exception is the production and provision by a foreign public agency. Chapter 4 is mainly dedicated to a detailed analysis of this provision arrangement.

<sup>32</sup> We will measure «government size» by «public expenditure» and use both terms interchangeably, henceforth. See more on public sector size proxies in Section 3.2.1.