

*Summary of empirical results on country size and public sector size*

cially in the private sector) outweigh this disadvantage. Nevertheless, the development of split ups suggests a decreasing importance of country size, which cannot be detected in the regressions.<sup>67</sup> Finally, the extent of federalism in different countries may play a crucial role. If regional governments produced and/or provided public goods on an inefficient scale, this would influence the results. The approach applied in this study implicitly assumes that there is no federal structure.

Recalling our discussion on the appropriate definition of a VSC in Section 2.3.2, we can now confirm our presumption. VSC have relatively larger public sectors than larger countries, and the prime suspects of this result from a theoretical viewpoint are diseconomies of scale. We therefore propose to define VSC in terms of the costs associated with publicly provided goods in accordance with the discussion in Section 2.3.2. Note that the number of inhabitants is implicitly accounted for in feature (c), and therefore only countries with a small population fulfill Definition 3:

*Definition 3:* A VSC is a country with the following characteristics:

- (a) full sovereignty and international recognition
- (b) the set of public goods provided by the VSC is comparable to the set of public goods provided by other sovereign countries.
- (c) a considerable part of the publicly provided goods exhibit *diseconomies* of scale in their production if they are produced in-house.

Note finally that there are three apparent possibilities for VSC to cope with those diseconomies of scale:

- They can simply accept their cost disadvantage. This would imply, from an economic viewpoint, that there have to be considerable advantages in other respects (advantage of sovereignty, more happiness in VSC), because otherwise the formation of VSC would not be stable in the long run, and there would hardly be so many of them in the world.

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<sup>67</sup> We will come back to this question in Chapter 5.