

4.2.1.2 Preference adequacy

The extent of preference adequacy is a central idea in economics, especially in the economic theory of federalism. It depicts the hitherto neglected demand side in our concept. Figure 4.2 gives an overview of its meaning by displaying per-capita provision costs of public goods (CO) and the marginal costs of not being able to comply with individual preferences, which we denote non-PA, because it can be viewed as the inverse of preference adequacy. It is obvious and intuitive that cost optimality and preference adequacy point in different directions. Figure 4.2 displays a pure public good, where the theoretically optimal number of consumers with regard to costs is infinite. In contrast, compliance with the preferences of the consumers decreases with an increasing number of consumers. Hence, non-PA is an increasing function of the number of consumers. The point of intersection of the two functions displays optimal jurisdiction size. Note that we assume in Figure 4.2 that the two functions are monotone and differentiable, which does not have to be the case in reality.

On the demand side, smaller countries have the benefit of being able to avoid a set of problems typical of larger countries (especially congestion⁷⁴, heterogeneity costs and costs of coordination). Additionally, political decisions are expected to be generally more in line with the electorate's preferences in smaller countries. Assuming that every inhabitant of a country has an individually optimal quantity-quality point on a continuous scale for any public good provided (for any policy pursued by the government), the sum of distances between those optimal points of all inhabitants and the point depicting the political decision(s) made is supposed to be smaller in small countries than in larger ones. To put it differently, «*the average cultural or preference distance between individuals is likely to be positively correlated with the size of the country*» (Alesina and Spolaore, 1997, p. 1029). This fact is generally attributed to the lack of cross-cutting cleavages and ethnic fractionalization as well as due to the cultural homogeneity of VSC.⁷⁵

⁷⁴ City states are a notable exception.

⁷⁵ Note that Chapter 5 provides contrasting evidence with regard to this proposition. We, therefore, conjecture in Chapter 5 that the stronger identification with one's own country in a VSC may be a promising explanation for the smaller distance that is described by Alesina and Spolaore (1997).