

5. The economics of sovereignty: «secrets of success» of very small countries

Recalling our analysis in Chapter 3, we know that VSC have a disadvantage due to their size. This is true for the private sector, where the size of the internal market is supposed to limit economic activity and growth⁹⁵, as well as for the public sector, where we detected a negative relationship between public sector size and country size. As to the private sector, it is obvious that openness and international can trade reduce this disadvantage. The high risk of exposure to economic shocks and/or natural hazards, which poses a threat to the whole economy of a VSC and not only to parts of it like in larger countries, still remains as a theoretical disadvantage.⁹⁶ Regarding the public sector, we had to conclude from Chapters 3 and 4 that there is higher public expenditure in smaller countries which may mainly be due to diseconomies of scale, but the difference between VSC and larger countries with regard to the ratio of public expenditure to GDP is surprisingly small. Chapter 4 offers some promising explanations for this latter fact, among which internationalization and international outsourcing seem to be the most important. Especially landlocked countries surrounded by peaceful neighbors are able to keep the costs of the negative size effect low.

Nevertheless, we have clear theoretical presumptions that when considering the economic system of VSC – including the private sector and the public sector – very small countries should, in theory, have a disadvantage and should not be able to reach similar welfare status or growth rates as larger countries.⁹⁷ Although this disadvantage may be

⁹⁵ See Section 5.1 for theoretical rationales of this disadvantage.

⁹⁶ Larger countries may also suffer from high dependencies on certain branches in the case of economic shocks, but, on average, VSC are more vulnerable.

⁹⁷ See Section 5.1.2 and Table 5.1 for a rather comprehensive list of theoretical arguments of VSC advantages and disadvantages.