production and provision of public goods that are associated with high costs or high levels of diseconomies of scale («organizational choice»). We are mainly interested in the possibilities and constraints of international outsourcing, where public good provision is sourced out to a public agency of another sovereign country. We speak of international outsourcing, for instance, in the case of the public good «external security» in Iceland, which is mainly provided by the U.S.A., because Iceland itself does not operate a defense force. The analysis of the organizational choice for a set of publicly provided goods in very small countries shows that international outsourcing is widespread; that there are some public goods which are simply not provided in very small countries (without leaving citizens apparently worse off), and some which are «tailored» to the needs and the size of the country. Nevertheless, we know from our results that international outsourcing, which is in most cases the least expensive alternative for very small countries, can only partly level out the negative size effect. The cost advantages of international outsourcing have already been implicitly considered in the empirical analysis of Chapter 3.

Chapter 5 dwells upon the central question raised above, which has hardly been assessed economically so far: Why is there a growing number of very small countries in the world and why do some of them exhibit a very high living standard, when they have a clear disadvantage in the public sector? It is not difficult to conclude intuitively that the private sector and the legislative framework for the private sector must be driving forces which leave very small countries better off today than a few decades ago. Again, standard economic theory provides a lot of arguments against the existence of very small countries; we test on a highly aggregated level whether small countries have lower levels of welfare than larger countries. Given that the theoretical expectation clearly arrives at an «inferiority» result for very small countries, it is comforting to find that welfare does not seem to depend on country size. In a next step, we build a set of eight high-income very small countries and try to find similar determinants of welfare in those countries. In order to obtain a better impression of the necessary extent of sovereignty and its interactions with the economy in small territories, we then compare very small countries to small autonomous regions with limited sovereignty. The striking result of Chapter 5 is that sovereignty is an important economic concept, which means that its impact on economics is enormous.