try. Elementary schools, transfer payments, police, etc. are generally provided on the lowest or – if existent – an intermediate jurisdictional level in large as well as in small countries. Concerning economies of scale per capita, expenditure for those goods should not be systematically dependent on country size. Moreover, these goods may be even more costly in larger countries with large agglomerations because of negative external effects associated with congestion phenomena.[35] Therefore, the argument has to be restricted to non-rival public goods, such as for example legal systems, external security, governments or monetary systems.

It is astonishing that a lot of these almost or entirely non-rival public goods are not produced by small countries, which does not mean that they are not provided. Take Liechtenstein, for example, a very small but nevertheless prosperous country. Liechtenstein does not «produce» an army or a monetary system and does not provide universities of its own. Important parts of its fiscal, social and legal system do not originate in the country. Liechtenstein leaves the production of public goods to its neighbors and restricts itself to guaranteeing provision through mostly advantageous contracts and treaties or simply free rides. The former is sometimes referred to as «international outsourcing», which elegantly grasps the main idea (see Gantner and Eibl, 1999); we will henceforth stick to this terminology and analyze international outsourcing thoroughly in Chapter 4. The negative connotations the term «free ride» do often not apply to VSC, since the marginal costs caused by the population of the VSC are close to zero in many cases and therefore negligible for large countries.[36] It is possible that marginal costs are even negative in special cases. The similarity between certain laws concerning the financial sector in Switzerland and Liechtenstein, which is the result of Liechtenstein adopting Swiss legislation, might be viewed as providing some advantages for Switzerland or Swiss citizens without extra costs.

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[35] Alesina and Wacziarg (1998) control for congestions in their regressions through population density, which seems to be a very rough measure on the country level, because the impact of congestions, intuitively, depends more on the existence of conurbations or big centers.

[36] The marginal costs of providing security to the Monegasque by the French army seems to be sufficiently close to zero (at least in peacetimes) to be neglected by the latter.