

Does country size matter for public sector size?

only a few. This development can, of course, be attributed to political changes and political determinants (the collapse of the Soviet Union³⁹ or the end of colonial rule). But judging by the evidence, the conclusion that split ups have become more feasible also from an economic viewpoint has to be taken into consideration.⁴⁰

Note that there are, of course, some convincing arguments in favor of smaller units along the line of the well-known phrase that «small is beautiful». They however go beyond traditional economic analysis in general, and we will account for them in detail in Chapter 5. One nevertheless has to be careful not to over-interpret the dynamics within the last century, because many regions or nations simply did not have the option to choose independence after World War 1. Moreover, there have also been phases in history where there were more sovereign entities in the world than now, although the international economic environment then was totally different.

- One might also argue that the size of the public sector may be constrained by a government's power to tax. Especially failed states are sometimes unable to collect taxes due to administrative inefficiency, corruption or widespread illegal economic activities. It is however not unreasonable to assume that country size and the actual power to tax are unrelated, so that we can leave revenue potentials aside.⁴¹

Obviously, country size is not only a question of economics. Ethnic heterogeneity, the political system, religion, security considerations, geographic conditions, the extent of federalism and the relationship with adjacent countries play a prominent role in the determination of the opti-

³⁹ It might be argued that the end of the Soviet Union is associated with centrifugal political forces mainly based on nationalism in the former Soviet Republics. There doubtlessly are many political explanations for the collapse of the super power. As an economist, one would nonetheless ask: Would the collapse have happened if split ups had not been so feasible from an economic point of view?

⁴⁰ For special treatment of the economic rationales for secessions see, e.g., Alesina and Spolaore (1997), Bolton and Roland (1997), Friedman (1977), Tietzel (1997) or Wittman (1991).

⁴¹ We tested for the influence of corruption, which should be strongly related with the power to tax, on public sector size in Section 3.2 but did not arrive at significant results, although we applied more than one possible index for corruption and bureaucratic (in)efficiency.