neral, and Gantner and Eibl (1999), who analyze public good provision in Liechtenstein and apply their central concepts to VSC and, especially, to international outsourcing.

4.2.1.1 Costs and economies of scale

So far, the cost-side has been discussed extensively with regard to economies of scale arguments, which are, without a doubt, the most important ones. But there are other cost disadvantages of smaller countries, two of which are however, on a closer inspection, associated with diseconomies of scale:[73]

– Easterly and Rebelo (1993) find that country size and the structure of tax systems are interrelated. Smaller countries seem to rely more heavily on inefficient taxes (e.g., custom taxes) than larger countries, which normally rely mainly on income taxes. They explain this heterogeneity by the high bureaucratic and setup cost of an income tax scheme. Hence, we have again a consequence or special case of the economies of scale argument in the context of tax levy.

– It is more difficult and more costly to provide external security in small countries than in larger ones, according to Alesina and Spolaore (1997). Again, if we simply consider «security» as a public good, we have an economies of scale problem. Conversely, one might argue that small countries are often too small or, more precisely, too unimportant to constitute a target in a war or conflict.

– Demand or supply shocks may hurt a smaller country more seriously, because it is often not able to compensate the affected region or sector with redistribution from the rest of the country or from other sectors, respectively (Sachs and Sala-i-Martin, 1992). Therefore, «insurance» against shocks may be more costly for small countries, and exposure to uninsurable shocks has more serious consequences.

[73] See also Alesina and Spolaore (1997).