

Table 4.3: Public goods with high costs and high economies of scale, when produced in-house in VSC

Public good	Costs in	Public good FPUBL	Costs in FPUBL
«very high» costs:		«high» costs:	
legislative branch	implausible	general administration	implausible
executive branch	implausible	secondary education	low
courts and judicial branch	implausible	higher education	low
foreign policy	very low	general health care	implausible
legal system	very low	hospitals	low
defense	very low	social security	low
monetary system	very low	highways	low
		railway infrastructure	low
		ports and airports	low
		tax levy	low

differences between VSC and larger countries are expected to be most pronounced. Hypothesis 1 states the theoretical expectation based on Table 4.3:

Hypothesis 1: Given very high or high costs of in-house production of a public good in a VSC, the government is expected to outsource production under conditions (1) and (2).

Condition 1: The cost difference between in-house production or provision and international outsourcing is high, and international outsourcing is the less expensive option.

Condition 2: Preference homogeneity between the VSC and, if the characteristics of the public good requires that, at least one adjacent country is sufficiently high.⁸⁰

Hypothesis 1 is tested for a set of public goods in 21 selected VSC. Strictly speaking, we test whether the production or provision of those goods which exhibit high economies of scale and therefore high costs is

⁸⁰ For some public goods, adjacency is irrelevant, as in the case of currencies. A VSC can introduce any currency it wants without relying on the currencies of adjacent countries.