which have proven to be wrong in the course of this study. Basic economic theory simply considers VSC as not optimal units, which is theoretically true for the private sector as well as for the public sector.

Starting with the public sector, we can by and large confirm theoretical predictions and existing empirical evidence (Alesina and Wacziarg, 1998). As noted above, smaller countries have larger public sectors than larger countries. The size effect is, however, moderate with respect to magnitude and explanatory power. On the aggregate level of government consumption or public expenditure, we therefore also confirm the results of Gantner and Eibl (1999), who find higher total public expenditure per capita in Liechtenstein than in Switzerland. It was not possible to perform such a differentiated analysis (with regard to single public functions) as Gantner and Eibl for a larger set of VSC due to serious data constraints and problems with comparability, but we can derive from our organizational approach in Chapter 4 that the picture that emerges from the Gantner-Eibl study is a general one and at least valid for many landlocked VSC.

In contrast to the public sector, we find a clear divergence between economic theory (e.g., Robinson, 1960) and empirical evidence with regard to VSC private sectors and welfare. Studies by Armstrong and Read (1995) and Armstrong et al. (1998) have already started to challenge the conventional wisdom that VSC have a general disadvantage owing to their small size by showing that very small countries do not have lower per capita GDP than adjacent regions (on NUTS 2 level) of larger countries. It is furthermore astonishing that many European VSC have even higher per capita GDP than the surrounding regions. Armstrong and Read and Armstrong et al., however, do not distinguish between VSC with full sovereignty and small autonomous regions with limited sovereignty, and their results hinge critically on the definition of adjacent regions (which seems easy for landlocked countries but is rather difficult for island regions).

We extend their results by means of a much more general approach and are able to show that there is no systematic influence of size on welfare measured by per capita GDP. What seems more like a trivial result is in effect a very strong indication that some economic theories are not valid for VSC and therefore cannot be applied. Given our results, it is especially misleading to concentrate on the supply or cost side of the economy, where VSC clearly have disadvantages, and to neglect demand