

2009 School Seminar Series

Waikato Management School
Te Raupapa



Political Economy of Infrastructure Investment

Monday 23rd February 2009
1.10pm – 2:00pm
MSB.1.03

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&

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Abstract

The importance of infrastructure for growth is well established in the macroeconomic literature. Previous research has treated public investment in infrastructure as exogenous. We remedy this shortcoming by providing a political economy analysis of infrastructure choice based upon consumer preferences derived from spatial competition models. In this setting, infrastructure investment has two possible effects: to directly lower transaction costs and indirectly to affect market power. We begin with a single marketplace model in which only the direct effect is present and then bring in the indirect effect by extending the analysis to competition on the circle. Analysis of market structure, consumer participation, entry and transport cost curvature give a rich variety of results. Socially optimal outcomes occur in some cases but infrastructure traps are common. Our results suggest that in less developed countries competition enhancing policies are a key prerequisite for public support of infrastructure investment.

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