Economic Growth
With Optimal Public Spending Composition

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Abstract

This paper uses a one-sector, endogenous growth model to study optimal composition between public investment and consumption in government expenditure and its relationships with economic growth. Assuming a benevolent government which maximizes a representative household's lifetime utilities, the paper determines the unique, interior public investment share in government’s budgets, which is determined by policy and structural parameters. It finds that the conventional determinants of economic growth now generate stronger growth effects, via their indirect impacts upon optimal public spending composition. The effects emerge from raising the marginal utility of private consumption, relative to the marginal utility of public consumption, thereby inducing public investment and increasing economic growth. Our quantitative results suggest that the growth effect is sizable. The large growth effect via optimal public investment in our model has implications to East Asian economic growth miracles where public investment share and economic growth are both higher than other area’s countries.

Key words: public consumption, public investment, economic growth
JEL classification: H41, H54, O41

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