

Boscá, José Emilio; Escribá, Javier; Murgui, María José

**Conference Paper**

## The Effect Of Public Infrastructures On The Private Productive Sector Of Spanish Regions

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# **The effect of public infrastructures on the private productive sector of Spanish regions.**

**40<sup>th</sup> Congress of the Regional Science Association**

J.E. Boscá\*, J. Escribá\* and M.J. Murgui\*  
June, 2000

## **Abstract**

In this paper we analyze the effect of infrastructures on cost and productivity performance of the private productive sector of Spanish regions over the 1980-1993 period. We use a dual approach based on cost functions that allows us to recover the usual parameters estimated with production functions. In addition, we obtain rates of return and cost elasticities of production factors at the regional level. Our framework considers explicitly that some factors are quasi-fixed and can be away from their optimal endowment levels. Our results indicate that the public sector has contributed significantly to enhance productivity and reduce costs in the private sector of almost every Spanish region. Nevertheless, there is still scope for the government to continue its investment efforts, given that it remains a sensible gap between existing and optimal public capital, and that we find that public capital promotes private investment in the long run.

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\*Universidad de Valencia.

## 1. Introduction.

Stimulated by the research carried out by Aschauer (1988, 1989a and b), many economists have analyzed the relationship between public investment in infrastructures and output, productivity and profitability in the private sector. The results obtained for the American private sector drew the economists' attention to this kind of literature because of the quantitative importance of infrastructures. According to Aschauer estimates of a Cobb-Douglas production function, a 1% increase in infrastructures expenditure meant an increase of 0.24 to 0.39% in the output of the private sector. Munnell (1990) confirmed the magnitude of these figures by making use of a similar sample, although the impact of infrastructures on productivity was reduced almost to 1/3 when using panel data techniques for the American states. Later studies such as Garcia-Mila's, McGuire and Porter's (1996) and Holtz-Eakin's (1994) have questioned the effect of infrastructures on productivity, pointing out some problems of econometric nature<sup>1</sup>, and arriving at results which were totally different to those of Aschauer's. Nevertheless, studies on the Spanish economy reveal some more optimistic results. In short, not only the analyses of the impact of infrastructures carried out with annual data by means of the estimation of production functions<sup>2</sup>, but also those papers that used panel data for the Spanish regions<sup>3</sup> have always obtained a positive impact of infrastructures for the whole Spanish economy.

Despite the fact that there is lot of research, which either supports or refutes the early conclusions Aschauer came to (see the surveys by Gramlich (1994), Draper and Herce (1994), de la Fuente (1996) and Sanaú (1997)), it seems pointless to conclude that public capital is not productive. So it can be argued that in a debate of this kind it is worthwhile trying for the Spanish case an alternative approach, which does not focus on the estimation of production functions. The idea is to allow for a more flexible relationship between public and private capital than the one implied in the Cobb-

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<sup>1</sup> Problems of endogeneity, non-stationarity, omission of variables, measurement error, etc.

<sup>2</sup> See Bajo and Sosvilla (1993), Argimón et al. (1994), Mas et al. (1993) and Serra and Garcia-Fontes (1994).

<sup>3</sup> See Mas et al. (1993), Serra and García-Fontes (1994) and Dabán and Murgui (1997).

Douglas technology<sup>4</sup>. In addition, we will take advantage of the analytical framework provided by duality theory by means of processing relevant information about input and output prices, and allowing the use of technological and behavioral restrictions.

In this paper we will make use of a dual approach based on cost functions (see Diewert (1986)), that has been already used for the analysis of the Swedish economy (see Berndt and Hansson (1992)), the German economy (see Conrad and Seitz (1992) and Seitz (1994)), the English economy (see Lynde and Richmond (1993a)), the American economy (see Morrison and Schwartz (1992 and 1996), Lynde and Richmond (1993b) and Nadiri and Mamuneas (1994)) and the Spanish economy (see Moreno, López-Bazo and Artís (1998), and Bosca, Dabán and Escribá (1999)). The specific functional form for the variable cost function we have chosen is a Generalized Leontief (see Morrison (1988)) which incorporates more-than-one fixed factor, nonconstant returns to scale, and allows for any degree of complementarity or substitutability between fixed and flexible inputs.

The impact of public infrastructures on output and production costs of the private productive sector of the Spanish regions will be analyzed using annual data for the 1980-93 period, that are taken from the BD.MORES database elaborated at the Spanish Ministry of Economy and Finance<sup>5</sup>. Our results confirm the relevance of using a theoretical framework that is flexible enough to consider the existence of quasi-fixed factors, which may not be used in their most efficient combination, and that allows to analyze explicitly the effects of infrastructure investment on private capital accumulation. The results indicate that the public sector has contributed significantly to enhance productivity and reduce costs in the private productive sector of almost every Spanish region. Nevertheless, there is still scope for the government to continue its investment efforts, given that it remains a sensible gap between effective and optimal public capital, and that we find that public capital promotes private investment in the long run.

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<sup>4</sup> The Cobb-Douglas form has been used more than any in the literature based on production functions, although it imposes rigid restrictions about inputs substitutability as Berndt and Hansson (1992) or Morrison and Schwartz (1992) have pointed out.

<sup>5</sup> See Dabán et al. (1998) for a description of the series included and the methodology employed to construct this database, that is available writing to the following e-mail address: adiaz-ballesteros@igae.meh.es

The article is structured into five sections. Section 1 is an introduction. Section 2 presents the theoretical model and its empirical specification. Section 3 presents a brief description of the data and some interesting facts about the evolution of the private sector in the Spanish regions. Section 4 presents our main results evaluating the impact of infrastructures both in the short as in the long term. Our final section deals with the most important conclusions.

## 2. Theoretical framework.

Assume that intermediate inputs ( $M$ ) and labor ( $L$ ) are variable inputs, and that private capital ( $K_P$ ) is a quasi-fixed factor in the short run. Firms, which cannot decide on its volume, are supplied with free services of public capital ( $K_G$ ). So, the production function may be written as follows:

$$Y = A(t) f(L, M, K_P, K_G) \quad (1)$$

where  $Y$  is output,  $A(t)$  represents the variable efficiency level and  $f$  is an homogeneous function of degree  $\lambda$  in  $L, M, K_P$  and  $K_G$ . Under competitive conditions, being  $w$  and  $v$  the price of labor and intermediate inputs respectively, the short run variable cost function  $G(\bullet)$  can be written as follows<sup>6</sup>:

$$G = G(\omega, v, Y, K_P, K_G, t) \quad (2)$$

Total cost ( $C$ ) will be the result of adding the fixed cost of private capital ( $P_{K_P} \cdot K_P$ ) to the variable costs, i.e.

$$C = G(\omega, v, Y, K_P, K_G, t) + P_{K_P} K_P \quad (3)$$

where  $P_{K_P}$  is the user cost of private capital. The firm does not incur any cost for the use of the fixed amount of infrastructures supplied by the public sector, so that these play the role of a positive externality for the individual firm. Notice that this cost

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<sup>6</sup> The variable cost function is assumed to be homogeneous of degree one, continuous, monotonically non-decreasing and concave in prices.

function can be obtained from the minimization of private production costs,  $\omega L + \nu M$ , subject to the production function (1). Applying Shephard's Lemma we can obtain the optimal input demand equations for the variable inputs as

$$X^* = \frac{\partial C(\cdot)}{\partial P_X} \quad \text{where } X = L, M \quad (4)$$

Further, differentiating the cost function (2) with respect to public capital, we obtain the shadow value of public capital ( $Z_{K_G}$ ), that can be expressed using Shephard's Lemma again, as

$$Z_{K_G} = -\frac{\partial G}{\partial K_G} = -\omega \frac{\partial L^*}{\partial K_G} - \nu \frac{\partial M^*}{\partial K_G} = LK_G + MK_G \quad (5)$$

which decomposes the cost changes associated with an increase in  $K_G$  into adjustment effects on private labor and intermediate inputs.  $LK_G$  denotes the response of the optimal demand for labor, and  $MK_G$  the response of the optimal demand for intermediate inputs, to an increase in infrastructures. As a consequence, for example,  $LK_G$  positive (negative) means that infrastructures and labor are substitutes (complements), given that an increase in public capital reduces (increases) labor costs.

In order to assess properly the impact of the provision of public capital on cost and productivity performance of firms it is convenient to translate the shadow price of public capital into an elasticity or shadow share measure like

$$S_{K_G}^* = \frac{Z_{K_G} \cdot K_G}{C} = -\frac{\partial C}{\partial K_G} \frac{K_G}{C} = -\epsilon_{C, K_G} \quad (6)$$

where  $S_{K_G}^*$  is the shadow share of public capital in total cost and  $\epsilon_{C, K_G}$  is the cost elasticity of public capital. Notice that we can also translate our  $LK_G$  and  $MK_G$  measures into the corresponding elasticities ( $\epsilon_{L, K_G}$  and  $\epsilon_{M, K_G}$ ).

A similar reasoning, although with some modifications, can be applied to private capital. Given that we consider private capital to be a quasi-fixed factor, its shadow price may be defined analogous to the public capital shadow price as the reduction in

variable costs due to an additional increase of the stock of private capital ( $Z_{K_P} = -\frac{\partial G}{\partial K_P}$ ).  $Z_{K_P}$  represents then the marginal benefit of investing in private capital. If the shadow price is positive, it means that an increase in private capital is cost saving for the firm, either because all variable inputs are substitutes with respect to private capital or because the substitutive effects upon private capital and some variable inputs outweigh the existing complementary effects. As before, we can translate the shadow value into a shadow share as follows:

$$S_{K_P}^* = \frac{Z_{K_P} \cdot K_P}{C} \quad (7)$$

However, in the case of private capital, given that it is a choice variable for the firm, an increase in private capital produces a direct cost (the user cost of capital) that has to be compared with the cost-saving benefit measured by the shadow price of private capital. The cost elasticity of private capital is then

$$\varepsilon_{C,K_P} = \frac{\partial C}{\partial K_P} \cdot \frac{K_P}{C} = (P_{K_P} - Z_{K_P}) \cdot \frac{K_P}{C} \quad (8)$$

If the shadow price is positive and higher than the user cost (i.e. the marginal benefit of investment is higher than the marginal cost), the cost elasticity will be negative, reflecting that the existing stock of capital is below its optimal level. In other words, the optimal demand for private capital in the long run will be that which fulfills  $P_{K_P} = Z_{K_P}$ , because when  $Z_{K_P}$  is higher than  $P_{K_P}$ , firms will require higher levels of private capital, given that the cost-saving benefits of an additional unit of capital outweigh the cost of investment.

Thus, we can assess the impact of the provision of public capital on the cost and productive performance of firms in two situations. First, when the private capital stock diverges from the optimal one, i.e. in the short run equilibrium. Second, when we impose that firms have adjusted their capital levels to the long run equilibrium, i.e.

when we impose<sup>7</sup> that  $P_{K_P} = Z_{K_P}$ . Then the optimal capital stock ( $K_P^*$ ) can be expressed as

$$K_P^* = h(w, v, P_{K_P}, Y, K_G, t) \quad (9)$$

and replacing it in equation (3), we obtain the long run cost function<sup>8</sup>:

$$\begin{aligned} C^L(w, v, P_{K_P}, Y, K_G, t) = & G^L(\omega, v, K_P^*(w, v, P_{K_P}, Y, K_G, t), Y, K_G, t) + \\ & + P_{K_P} K_P^*(w, v, P_{K_P}, Y, K_G, t) \end{aligned} \quad (10)$$

From equation (9) we can derive an elasticity measure of the impact of public capital on the optimal private capital stock ( $\varepsilon_{K_P^* K_G}$ ), under the assumption that there are no adjustment costs. In addition, consequently with equation (10) we can reconsider the short run shadow value of public capital and the corresponding short run elasticities and convert them into long run measures.

Finally, although we are assuming that public capital is an external factor that private firms can not influence, we can derive different measures for the optimal public capital stock, under the assumption that the government would minimize firms short run total costs. Thus, if we assume different values for the user cost of public capital ( $P_{K_G}$ ) we can compute the optimal public capital stock as<sup>9</sup>

$$K_G^* = h(w, v, P_{K_G}, Y, K_P, t) \quad (11)$$

As mentioned above, we have chosen a Generalized Leontief variable cost function to estimate the parameters needed to calculate the shadow values and elasticities shown in previous paragraphs. The specification of the Leontief function is

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<sup>7</sup> Notice that  $P_{K_P} = Z_{K_P}$ , is the first order condition that results from minimizing equation (3) of short run total costs with respect to  $K_P$ .

<sup>8</sup> See Schankerman and Nadiri (1986), and Kulatilaka (1985).

<sup>9</sup> In our framework public capital is an unpaid input for the firm, so that a positive  $Z_{K_G}$  implies always that the firm desires more public investment in infrastructures. Nevertheless, the government should take into account the social costs of infrastructures, *i.e.*  $P_{K_G} \neq 0$ , to assess properly its impact on private sector performance.



the same as in Morrison (1988) which incorporates fixed inputs and does not impose the degree of returns to scale. It can be expressed as<sup>10</sup>

$$G = Y \left[ \sum_i \sum_j \alpha_{ij} P_i^{1/2} P_j^{1/2} + \sum_i \sum_m \delta_{im} P_i s_m^{1/2} + \sum_i P_i \sum_m \sum_n \gamma_{mn} s_m^{1/2} s_n^{1/2} \right] + Y^{1/2} \left[ \sum_i \sum_k \delta_{ik} P_i x_k^{1/2} + \sum_i P_i \sum_m \sum_k \gamma_{mk} s_m^{1/2} x_k^{1/2} \right] + \sum_i P_i \sum_k \sum_l \gamma_{lk} x_k^{1/2} x_l^{1/2} \quad (12)$$

where  $P_i$  and  $P_j$  denote the prices of variable inputs  $V_i$ ,  $x_k$  and  $x_l$  are the quasi-fixed inputs ( $K_P$  and  $K_G$ ); and  $s_m$  and  $s_n$  denote the remaining arguments ( $Y$  and  $t$ ). Using Shephard's lemma, we get the two input demand equations for the variable inputs<sup>11</sup> that we can write as

$$V_i = \frac{\partial G}{\partial P_i} = Y \sum_j \alpha_{ij} \left( \frac{P_j}{P_i} \right)^{1/2} + Y \sum_m \delta_{im} s_m^{1/2} + Y \sum_m \sum_n \gamma_{mn} s_m^{1/2} s_n^{1/2} + Y^{1/2} \left[ \sum_k \delta_{ik} x_k^{1/2} + \sum_m \sum_k \gamma_{mk} s_m^{1/2} x_k^{1/2} \right] + \sum_k \sum_l \gamma_{lk} x_k^{1/2} x_l^{1/2} \quad (13)$$

Following Morrison and Schwarz (1996) we add to the previous system of three equations a fourth one that captures firms profit maximization behavior. This equation is a short run pricing equation that equates the price of output ( $P_Y$ ) to the marginal cost ( $MC$ ). It has to be emphasized that such a condition is not being imposed but estimated, so that the residual of this equation may capture the extent to which regions have some market power.

$$P_Y = MC = \frac{\partial G}{\partial Y} = \sum_i \sum_j \alpha_{ij} P_i^{1/2} P_j^{1/2} + \sum_i \sum_m \delta_{im} P_i s_m^{1/2} + \sum_i P_i \sum_m \sum_n \gamma_{mn} s_m^{1/2} s_n^{1/2} + 1/2 Y^{-1/2} \left[ \sum_i \sum_k \delta_{ik} P_i x_k^{1/2} + \sum_i P_i \sum_m \sum_k \gamma_{mk} s_m^{1/2} x_k^{1/2} \right] + 1/2 Y^{1/2} \sum_i \delta_{iY} P_i + Y^{1/2} \left[ \sum_i P_i \sum_m \gamma_{mY} s_m^{1/2} \right] + 1/2 \sum_i P_i \sum_k \gamma_{Yk} x_k^{1/2} \quad (14)$$

<sup>10</sup> Notice that we are employing almost the same notation as in Morrison and Schwarz (1996).

<sup>11</sup> To accommodate heteroscedasticity we will estimate equations (12) and (13) divided by output ( $Y$ ).

The previous system of four equations will be estimated to obtain the relevant parameters of the cost function, that we will use to calculate the shadow prices, elasticities and other relevant measures for the analysis of the effect of infrastructures.

### **3. The Data.**

The basic data for the seventeen Spanish regions are taken from the BD.MORES database. The level of regional disaggregation correspond to NUTS2 in Eurostat nomenclature of statistical territorial units (see Dabán et al. (1998)). This database allows us to assemble series of gross value added<sup>12</sup>, gross earnings of private employees, number of employees, public and private capital stocks<sup>13</sup>, user costs of private and public capital and the necessary price indices for the period 1980-1993. The series of intermediate inputs and their price indices are taken from Díaz (1998), and are fully compatible with BD.MORES data. The output measure used in this paper is gross output, which results from adding intermediate inputs to gross value added.

Table 1 presents the evolution of the main economic magnitudes for the private sector in the whole of the Spanish economy. The first column corresponds to gross output, which shows the cyclical pattern of the Spanish economy. Labor and intermediate inputs are clearly pro-cyclical, presenting average negative rates of growth from 1980 to 1985 and positive rates of growth from 1985 onwards.

Differences in growth rates among the productive factors are important. For the period as a whole public capital displays the highest annual average growth rate (4.9%), followed by private capital (2.4%) and intermediate inputs (2.0%), whereas on average employment remained almost constant. Nevertheless, it is clear that during the 1980-85 crisis, the growth rates of output and productive factors (except infrastructures) were very low, being even negative for employment and intermediate inputs. The economic

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<sup>12</sup> Gross value added includes production of goods and services at factor costs, produced in the region, by the private productive sectors: agriculture (forestry and fishing), industry (mining, manufacturing, construction and utilities) and private services (commerce, transport, and communications, banking and other private services). Housing rents are excluded.

<sup>13</sup> Private capital data refer to the net stock of capital held by the productive private sector. Thus, it does neither include the stock of residential buildings, nor the stock in productive infrastructures. Public capital data refer to the net stock of productive infrastructure. It comprises transportation networks, energy supply networks, water supply and sewage systems. They may be offered by government or government agencies, by regulated private or public enterprises, and by public or private organizations.

expansion experienced in Spain from 1986 to 1992 is also apparent in the figures, being quite noticeable the rates of growth of infrastructures in these years.

**Table 1. The private sector in Spain.**

	Gross Output	Private Capital	Public Capital	Labor	Intermediate Inputs
	Y	K <sub>P</sub>	K <sub>G</sub>	L	M
<b>1980</b>	22520	21259	3192	10054	10554
<b>1981</b>	21857	21699	3243	9701	9990
<b>1982</b>	21984	22037	3360	9546	10017
<b>1983</b>	22316	22362	3482	9448	10138
<b>1984</b>	22600	22557	3575	9157	10205
<b>1985</b>	22798	22682	3720	9258	10117
<b>1986</b>	23695	23003	3891	9359	10632
<b>1987</b>	25081	23581	4069	9750	11287
<b>1988</b>	26564	24384	4298	10053	12071
<b>1989</b>	28052	25453	4630	10330	12906
<b>1990</b>	29125	26496	5053	10654	13441
<b>1991</b>	29729	27497	5452	10690	13758
<b>1992</b>	29775	28395	5761	10441	13794
<b>1993</b>	29316	28799	5927	10031	13507
<b>Average Annual Growth</b>					
<b>Rate 1980-93 (%)</b>	2,085	2,370	4,898	0,018	1,979
<b>1980-85 (%)</b>	0,259	1,306	3,116	-1,623	-0,815
<b>1986-93 (%)</b>	3,226	3,035	6,012	1,044	3,725

Note: Figures are in thousands of millions 1980 pesetas, except labor that is in thousands of employees.

In table 2 we present information about regional disparities in the same economic variables analyzed before. Asturias is the region that has the lowest rate of growth in output, employment and intermediate inputs. Madrid, on the other hand, displays high growth rates of output and all productive factors. Infrastructures have grown in all regions at a higher rate than private capital (with the exceptions of La Rioja and Navarre), showing the important investment effort carried out by Spanish federal or local governments.

The last column of table 2 shows the weight of the private sector of each region in Spanish total gross output. As can be appreciated only five regions produce 63% of

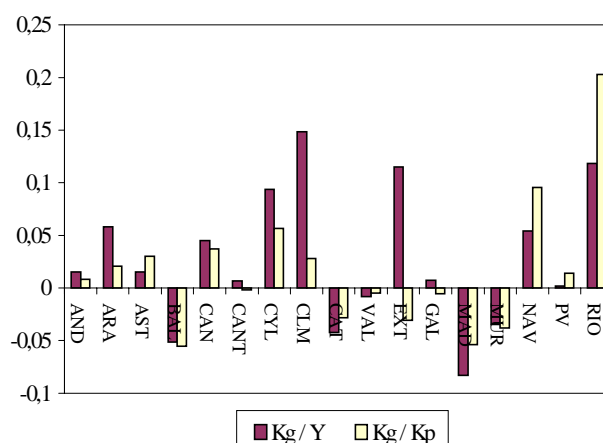
gross output of the private sector in Spain (Catalonia (20%), Madrid (13%), Andalusia (13%), Valencia (9%) and Basque Country (8%)).

**Table 2. Regional disparities in the private sector.**

	$\hat{Y}$	$\hat{K}_P$	$\hat{K}_G$	$\hat{L}$	$\hat{M}$	$Y_i/Y$
<b>Regions</b>						
<b>Andalusia</b>	2,00	2,28	7,58	0,05	1,77	0,13
<b>Aragon</b>	2,75	1,74	2,52	-0,15	2,99	0,04
<b>Asturias</b>	0,42	1,84	4,63	-1,42	0,26	0,03
<b>Baleares</b>	2,93	2,15	4,60	0,59	2,91	0,02
<b>Canary Islands</b>	2,64	2,76	3,67	0,56	2,51	0,03
<b>Cantabria</b>	1,93	1,23	6,04	-1,33	2,01	0,02
<b>Castile and Leon</b>	1,88	1,63	3,10	-1,06	1,96	0,07
<b>Castile-La Mancha</b>	1,67	2,30	4,51	-0,32	1,40	0,03
<b>Catalonia</b>	2,27	2,64	4,27	0,22	2,07	0,20
<b>Valencia</b>	1,77	2,94	5,64	0,41	1,89	0,09
<b>Extremadura</b>	2,89	1,65	4,94	-0,77	2,92	0,02
<b>Galicia</b>	1,60	2,16	3,95	-1,24	1,62	0,06
<b>Madrid</b>	2,57	3,60	5,91	1,30	2,23	0,13
<b>Murcia</b>	2,00	2,31	8,46	0,68	1,63	0,02
<b>Navarre</b>	2,39	2,82	2,45	0,31	2,62	0,02
<b>Basque Country</b>	1,05	0,97	4,12	-0,39	0,99	0,08
<b>La Rioja</b>	2,26	2,66	0,13	-0,21	2,21	0,01

Note: Average annual growth rates, 1980-1993.

Finally, figure 1 shows the relative position of each region in relation to the national average in terms of the ratio of public to private capital and of public capital to output. It is obvious that there are again considerable disparities among the Spanish regions. La Rioja and Navarre are the regions with the highest ratio of public to private capital, and together with Castile-La Mancha, Castile and Leon, Canary Islands, Asturias, Aragon, Basque Country and Andalusia are over the national average. On the other hand, it is worthwhile pointing out the low endowment of public capital in relation to both output and private capital in Madrid, Baleares, Catalonia, Murcia and Valencia.



**Figure 1. Ratios of public capital to output and private capital. 1980-93 averages.<sup>14</sup>**

#### 4. Results for the Spanish private sector.

We have estimated equations (12), (13) and (14) using seemingly unrelated regressions (SUR) techniques. Estimation was carried out using annual data from 1980 to 1993 for the 17 Spanish regions. This procedure allows us to impose the theoretical restrictions that derive from Shephard's lemma, while gaining degrees of freedom in the estimation. Furthermore, estimating the model as a system adds structure and increases efficiency of the estimates (standard errors are lower). As is well known, the usual practice in this kind of literature is to impose the theoretical cross-equation restrictions, without presenting formal tests that give statistical support to them. Usually, this is justified only as a way of obtaining reasonable results from an economic point of view. Nevertheless, in table A.1 in the appendix we present the parameter estimates from our preferred specification, along with two different specification tests.

On the one hand, Shankerman and Nadiri (1986) elaborated a specific econometric test to investigate the divergence of quasi-fixed factors from their static equilibrium levels. The hypothesis to be tested is whether the parameters obtained from

<sup>14</sup> Key to region names: AND=Andalusia; ARA= Aragon; AST= Asturias; BAL= Baleares; CAN= Canary Islands; CANT= Cantabria; CYL= Castile and León; CLM= Castile-La Mancha; CAT= Catalonia; VAL= Valencia; GAL= Galicia; EXT= Extremadura; MAD= Madrid; MUR= Murcia; NAV= Navarre; PV= Basque Country; RIO= La Rioja.

the estimate of the short run specification, coincide with those which are obtained from the estimate of the first order condition  $Z_{K_P} = P_{K_P}$ . Intuitively, if private capital is at its optimal level the coefficients estimated from the equation representing optimal capital endowment, will coincide with the coefficients estimated from the model where private capital is assumed to be a quasi-fixed factor and consequently away from its static equilibrium. As can be seen in table A.1, the hypothesis that private capital is close to its static equilibrium level is strongly rejected<sup>15</sup>. The conclusion is that the stock of private capital cannot be found at the optimal level, and therefore it must be considered when specifying the model as a quasi-fixed factor.

The previous conclusion is reinforced when considering the result we get from testing the parameter restrictions implied by Shephard's lemma. As can be seen in table A.1, it is possible to accept the null hypothesis that labor and intermediate inputs are at their optimal demand levels<sup>16</sup>. If we instead specify the model assuming that private capital is another flexible input, so that we add a third input demand equation, the parameter restrictions implied by Shephard's lemma are strongly rejected. This implies that Shephard's lemma can only be verified if we assume that private capital behaves as a quasi-fixed factor in the short term, which is coherent with the results of the Shankerman and Nadiri test. This is potentially an important result, because it is common practice in the duality literature to impose the restrictions derived from Shephard's Lemma and/or to assume private capital being a flexible or a quasi-fixed input, despite the fact that the implied restrictions are verified by means of formal

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<sup>15</sup> This result is similar to the one which Moreno, López Bazo and Artís (1998) obtained for the manufacturing branches in Spanish regions.

<sup>16</sup> The dummy variables included in the equations are very important to get this result. In fact, if the model is estimated with none of these variables, the test rejects the null hypothesis ( $\chi^2(32)=48.42$ , P-Value = 0.031). We tried also to estimate a fixed effects model, incorporating regional-specific intercept terms in both input demand equations. Nevertheless, this means incorporating 17x4 additional cross-equation restrictions to the system, that are strongly rejected by statistical tests. In addition, the imposition of those restrictions alters considerably the values obtained for the rest of the coefficients. This casts serious doubts on the plausibility of these results, so that we finally decided to pick up regional heterogeneity by introducing only two dummy variables. The first dummy takes the value one in Catalonia, Madrid, Valencia and Murcia and zero in the rest, and the second takes the value one in Castile-La Mancha, Extremadura, Castilla-León, Navarre, Rioja and Cantabria and zero in the rest. These two groups have been chosen because regions in the first group display very low  $K_G/Y$  and  $K_G/K_P$  ratios compared to the national average. Additionally, those regions have a considerable weight in the output of the Spanish private sector. The second set of regions follows an opposite pattern.

econometric tests. In our case common practice and econometric tests go in the same direction, making us quite confident that our model specification points into the right direction.

As mentioned before, the estimated coefficients in the specification finally chosen are shown in table A.1 in the appendix. Overall, the fit of the four equations is high and the estimated coefficients are statistically significant, although the sign<sup>17</sup> and magnitude of them has little intuitive value from an economic viewpoint given the complexity of the cost function used. The shadow values, elasticities and other measures of cost and productive performance discussed in the theoretical section have been obtained from the estimates presented in table A.1, and are summarized in tables 3, 4 and 5.

As can be seen in table 3, where we present results for the whole of the Spanish private sector<sup>18</sup>, the shadow price of private capital (col. 2) shows an upward trend throughout the period, with the user cost (col. 1) fluctuating around it. This means that for the economy as a whole, the stock of private capital has not been persistently away from its long run equilibrium level<sup>19</sup>. The average  $Z_{K_P}$  measure means that a 1-million 1980 pesetas investment in private capital results in 112.000 pesetas cost saving for one year. From these the average region saves 190.000 pesetas in intermediate inputs (col.4), while it spends 79.000 additional pesetas in the labor input (col.3). As a consequence, the negative  $LK_P$  means that private capital and labor are complements, while the positive  $MK_P$  measure implies a substitutive relationship between intermediate inputs and private capital.

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<sup>17</sup> Nevertheless, the sign of certain coefficients need to be consistent with the so-called curvature conditions (see Diewert and Wales (1987) or Morrison and Schwarz (1994)). In our case, the condition that  $\sum \gamma_{kk} > 0$  was not satisfied, so that we imposed that  $\sum \gamma_{kk} = 0.40$ , which is accepted at conventional significance levels. The reason to impose that the sum of the two implied coefficients is 0.40, is that this value is among all the positive values which are statistically acceptable the most “conservative” one, in the sense that it generates levels of  $K_P^*$  closer to the observed levels of  $K_P$ .

<sup>18</sup> If not stated otherwise the average results for the whole Spanish economy are computed as non-weighted regional averages.

<sup>19</sup> Recall that, as Kulatilaka (1985) points out, the counterpart that the shadow price does not coincide with the user cost is that the optimal capital stock does not coincide with the effective one.

**Table 3. Shadow prices in the private sector.**

Years	$P_{KP}$	$Z_{KP}$	$LK_P$	$MK_P$	$Z_{KG}$	$LK_G$	$MK_G$
Regional averages	[1]	[2]	[3]	[4]	[5]	[6]	[7]
<b>1980</b>	0,043	0,062	-0,109	0,171	0,321	0,264	0,057
<b>1981</b>	0,079	0,072	-0,089	0,162	0,370	0,213	0,157
<b>1982</b>	0,099	0,080	-0,078	0,158	0,367	0,184	0,183
<b>1983</b>	0,089	0,090	-0,075	0,166	0,365	0,176	0,190
<b>1984</b>	0,126	0,102	-0,071	0,175	0,358	0,168	0,189
<b>1985</b>	0,110	0,113	-0,068	0,181	0,325	0,150	0,177
<b>1986</b>	0,127	0,112	-0,074	0,183	0,287	0,168	0,132
<b>1987</b>	0,156	0,120	-0,080	0,196	0,261	0,194	0,084
<b>1988</b>	0,132	0,125	-0,083	0,205	0,249	0,216	0,048
<b>1989</b>	0,146	0,133	-0,083	0,212	0,219	0,223	0,015
<b>1990</b>	0,157	0,138	-0,081	0,216	0,183	0,214	-0,012
<b>1991</b>	0,146	0,142	-0,079	0,217	0,153	0,199	-0,026
<b>1992</b>	0,155	0,143	-0,072	0,213	0,143	0,175	-0,014
<b>1993</b>	0,113	0,143	-0,061	0,203	0,137	0,139	0,012
<b>Average</b>	0,120	0,112	-0,079	0,190	0,267	0,192	0,085
<b>Standard deviation<sup>1</sup></b>		0,0044	0,0045	0,0077	0,0208	0,0225	0,0323

**Note:** All figures are expressed in 1980 constant pesetas. <sup>1</sup>Standard deviation of the sample mean.

With regard to the shadow price of public capital (col. 5),  $Z_{KG}$  shows a clear decreasing trend. The high values in the first years reveal the scarcity of infrastructures in the Spanish economy at the beginning of the eighties. Nevertheless, the declining pattern of the gross return to public capital indicates that the government has contributed significantly to reduce the existing gap between optimal and existing public capital. Finally, columns 6 and 7 provide additional information about the distribution of the cost saving benefits of infrastructures investment. Public capital reduces private cost through a reduction of expenditure in intermediate inputs until 1990 and through the reduction of labor cost. Most noticeable is the fact that while private capital and labor are complements, infrastructures and labor seem to be substitutes.

In table 4 we can find similar information as in table 3, but at the regional level. There are important regional disparities, for example, the shadow price of private capital (col. 2) is on average higher than the user cost (col. 1) in Andalusia, Castilla-León, Catalonia, Valencia, Madrid, Navarre, Basque Country and La Rioja. Thus, as it has been already argued, this implies that in these regions effective private capital has been on average below its optimal level. It is noticeable that from these eight regions, seven



out of them are the ones with more weight in Spanish total gross output (jointly these regions represent more than 70 per cent of private production). This is the reason why the non-weighted average of the elasticity of cost to private capital (col. 3) is positive, while the same elasticity is negative for the whole Spain (constructed weighting regional relative cost shares). This is an important result, because additional private investment efforts in the regions with more weight in Spanish output will have benefited the firms in these regions through the reduction of production costs. In contrast, the nine regions with positive cost elasticities and consequently where effective private capital has been on average above the optimal one, represent less than 30 per cent of total output. In columns 4 and 5 we can find further information of the impact of private capital on the cost performance of private firms in Spanish regions. In all the regions, except in Castile-La Mancha and Extremadura, additional private capital endowments result in labor costs increases (col. 4). Also with the exception of Extremadura, private capital reduces costs through the substitution of intermediate inputs (col. 5). Summing up in almost every Spanish region private capital and labor are complements while intermediate inputs and private capital are substitutes.

With regard to the shadow price of public capital (col. 6), as expected it is positive in all regions, with the exceptions of Castile and Leon and La Rioja<sup>20</sup>, showing the productive effect of infrastructures and the benefit in terms of cost reductions to private firms. Given that we are assuming that infrastructures are supplied freely, private firms do not face a user cost, so that the elasticity of cost to public capital (col. 7) is negative in the fifteen regions where  $Z_{K_G}$  is positive.

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<sup>20</sup> The fact that shadow prices of public capital in Castile and Leon and La Rioja are negative falls into incoherence from a theoretical point of view. However, La Rioja displays an unusual pattern because of its very high initial ratios of public to private capital and public capital to output, and because it is the only region where public capital has almost not grown along the sample period.

**Table 4. Shadow prices and cost elasticities. Average values, 1980-93.**

	$P_{KP}$	$Z_{KP}$	$\epsilon_{C,KP}$	$\epsilon_{L,KP}$	$\epsilon_{M,KP}$	$Z_{KG}$	$\epsilon_{C,KG}$	$\epsilon_{L,KG}$	$\epsilon_{M,KG}$
Regions	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
Andalusia	0,118	0,159	-0,044	0,139	-0,461	0,041	-0,001	-0,222	0,176
Aragon	0,119	0,093	0,030	0,167	-0,353	0,230	-0,054	0,002	-0,109
Asturias	0,121	0,103	0,017	0,325	-0,413	0,223	-0,040	-0,066	-0,033
Baleares	0,119	0,009	0,128	0,196	-0,197	0,931	-0,125	-0,039	-0,239
Canary Islands	0,117	0,114	0,003	0,255	-0,484	0,184	-0,043	-0,018	-0,076
Cantabria	0,123	0,043	0,085	0,275	-0,296	0,534	-0,091	0,026	-0,200
Castile and Leon	0,118	0,148	-0,036	0,190	-0,494	-0,038	0,010	-0,074	0,078
Castile-La Mancha	0,112	0,086	0,042	-0,068	-0,244	0,161	-0,048	0,153	-0,224
Catalonia	0,127	0,184	-0,052	0,138	-0,448	0,030	-0,004	-0,305	0,231
Valencia	0,123	0,141	-0,019	0,176	-0,429	0,156	-0,025	-0,167	0,079
Extremadura	0,111	0,011	0,192	-0,413	0,338	0,540	-0,137	0,267	-0,574
Galicia	0,115	0,104	0,011	0,152	-0,354	0,283	-0,050	-0,099	-0,021
Madrid	0,130	0,149	-0,015	0,213	-0,436	0,388	-0,036	-0,224	0,125
Murcia	0,115	0,037	0,086	0,196	-0,221	0,819	-0,107	-0,030	-0,187
Navarre	0,124	0,169	-0,041	0,425	-0,562	0,051	-0,012	-0,016	-0,012
Basque Country	0,128	0,145	-0,017	0,244	-0,449	0,144	-0,024	-0,157	0,067
La Rioja	0,118	0,217	-0,084	0,667	-0,667	-0,169	0,058	0,062	0,062
Average	0,120	0,112	0,017	0,193	-0,363	0,267	-0,043	-0,053	-0,050
Spain <sup>1</sup>			-0,011	0,171	-0,411		-0,028	-0,153	0,063
Standard deviation <sup>2</sup>		0,004	0,005	0,014	0,015	0,021	0,004	0,009	0,012

Notes: <sup>1</sup>The elasticities for Spain are obtained as weighted averages, taken as weights the ratios of the regional value of the variable to the national value.

<sup>2</sup>Standard deviation of the sample mean.

The relationship between public capital and labor and intermediate inputs is also shown in the last two columns of table 4. Public capital and labor are substitutes in most regions (except in Aragon, Cantab  a, Castile-La Mancha and Extremadura), contrasting sharply with the complementary relationship among labor and private capital shown before. Finally, there are important regional disparities in the relationship between infrastructures and intermediate inputs. Both factors are substitutes in ten regions and complements in seven. The important fact is that these seven regions are again the biggest ones, which represent jointly more than 70 per cent of Spanish gross output. This explains that the simple regional average of the elasticity of public capital to intermediate inputs takes a negative value (-0.050), while the Spain measure (the weighted average) is positive (0.063).

In table 5 we translate our cost performance measures into output elasticities and returns to scale measures. Our results for the whole of the Spanish economy seem quite reasonable, indicating that the estimation of cost functions may be appropriate to analyze the productive effects of quasi-fixed inputs. With regard to output elasticities<sup>21</sup>, table 5 shows that the values for the whole of the Spanish private productive sector are 12.7% for private capital and 2.6% for public infrastructures. Given that our output measure is gross output, these elasticities would be around 23% for private capital and 9% for public capital, if the variable considered were gross value added. As before there are also significant differences across regions, that confirm the regional pattern that emerges from the analysis of previous results<sup>22</sup>. Finally, the last two columns of table 5 show information about short run returns to variable inputs and long run returns to scale<sup>23</sup>. For the average region, returns to scale are almost constant ( $\lambda^{LR} \approx 0,97$ ), although firms are producing not only over the minimum of their average variable costs,

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<sup>21</sup> Output elasticities are computed as is common in this literature according to the formulas  $\varepsilon_{Y,Kp} \equiv \frac{S_{Kp}^*}{\varepsilon_{C,Y}}$

and  $\varepsilon_{Y,Kg} \equiv \frac{S_{Kg}^*}{\varepsilon_{C,Y}}$ , where  $\varepsilon_{C,Y}$  is the short run elasticity of total cost to output.

<sup>22</sup> In most Spanish regions the values of the output elasticities are quite reasonable, although there are a few exceptions.

<sup>23</sup> Short run returns to variable inputs are defined as the ratio of average variable costs to marginal costs, while long run returns are obtained adding the output elasticities of the four productive inputs.

but also over the minimum of total costs in the short term ( $\lambda^{SR} \approx 0,83$ ). In this case, regional disparities in the degree of short or long run returns are not as important as in other indicators, indicating a quite reasonable pattern of the Spanish private sector: regions operate under constant returns to scale, but with decreasing returns to variable factors in the short run.

**Table 5. Output elasticities and returns to scale. Average values, 1980-93.**

	$\epsilon_{Y,KP}$	$\epsilon_{Y,KG}$	$\lambda^{SR}$	$\lambda^{LR}$
Regions	[1]	[2]	[3]	[4]
Andalusia	0,159	0,001	0,819	0,975
Aragon	0,107	0,053	0,840	0,991
Asturias	0,092	0,039	0,871	0,993
Baleares	0,008	0,108	0,749	0,841
Canary Islands	0,118	0,040	0,814	0,940
Cantabria	0,041	0,084	0,807	0,951
Castile and Leon	0,160	-0,010	0,810	0,997
Castile-La Mancha	0,138	0,049	0,842	1,002
Catalonia	0,162	0,004	0,848	0,988
Valencia	0,135	0,024	0,825	0,969
Extremadura	0,009	0,158	0,913	1,017
Galicia	0,106	0,049	0,858	1,014
Madrid	0,103	0,032	0,795	0,931
Murcia	0,036	0,102	0,835	0,933
Navarre	0,136	0,011	0,808	0,968
Basque Country	0,127	0,022	0,814	0,981
La Rioja	0,165	-0,051	0,806	0,913
Average	0,106	0,042	0,827	0,965
Spain <sup>1</sup>	0,127	0,026	0,828	0,972
Standard deviation <sup>2</sup>	0,0043	0,0036	0,0028	0,0030

Notes: <sup>1</sup>The elasticities for Spain are obtained as weighted averages, taken as weights the ratios of the regional value of the variable to the national value. <sup>2</sup>Standard deviation of the sample mean.

The analysis in previous paragraphs has a short run nature, in the sense that it has not taken into account the existence of an indirect effect of public capital on the desired stock of private capital. In other words, the possible complementary or substitutable relationship between public infrastructures and private capital can be further investigated. As shown in the theoretical section, we can determine the stock of

optimal private capital by means of equation (9), given the amount of infrastructures. In the first column of table 6 we present the ratio of optimal to effective private capital. Regional disparities in this indicator are the same as the ones presented in previous tables, namely the biggest regions show on average a relative shortage of private capital, while the smallest regions had effective private capital above optimal one. Again, the simple and the weighted regional averages reflect this fact.

Figures 2 and 3 show the evolution of the shadow price of private capital and its user cost, as well as the stock of optimal capital and the existing one for the whole Spanish private sector. As can be appreciated both figures are mirror images. There have been not remarkable discrepancies between optimal and effective capital stock from 1980 to 1988, although from 1988 to the end of the sample period there has been persistent over-utilization of production capacity.

As stated before, the optimal stock of private capital depends on the endowment of public capital, so we can study the relationship that exists between them. Actually, it is very interesting to calculate the effect of an increase in infrastructures on the optimal private capital stock. Column 2 of table 6 shows the average value of the elasticity of optimal private capital to public infrastructures for each region. In all of them and throughout the whole period both factors are complements ( $\varepsilon_{KP*KG} > 0$ ). Thus, infrastructures generate a positive impact on the shadow price of private capital, and as a result they help promoting new investment in private capital in the long run.

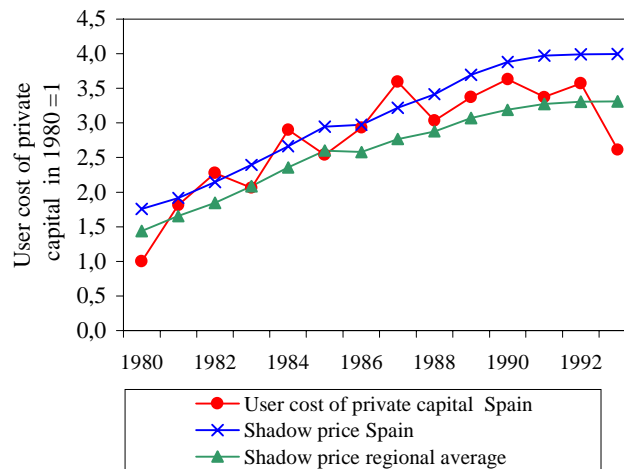
Assuming that firms in each region have reached the optimal private capital stock, the next step is to calculate the shadow price of public capital in this situation. As can be seen in column 3, the long run shadow price of public capital is positive in all the regions, with especially high values in Madrid, Murcia, Baleares, Catalonia and Valencia. The gross return to infrastructures is consequently high in most regions, reflecting the fact that there is still scope for the Spanish local or federal government to continue its investment efforts to alleviate the scarcity of infrastructures in the long run. The same conclusion can be obtained looking at the cost elasticity to public capital (col. 4), which is negative in all regions, and does not present important disparities across big and small regions.

**Table 6. Long run elasticities.**

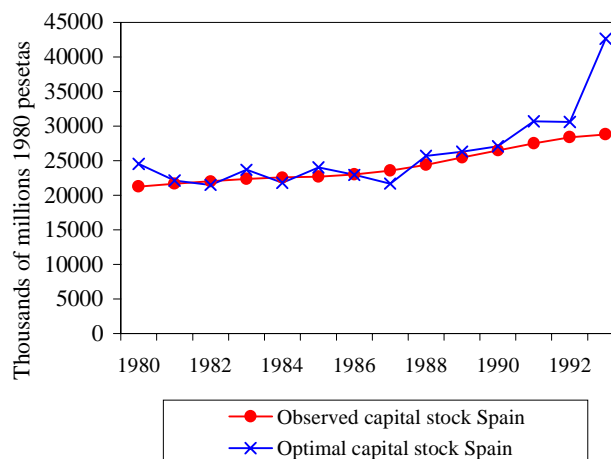
	$K_P^*/K_P$	$\epsilon_{KP^*,KG}$	$Z_{KG}^L$	$\epsilon_{CKG}^L$	$\epsilon_{LKG}^L$	$\epsilon_{MKG}^L$	$\epsilon_{YKG}^L$	$\epsilon_{YKP}^L$
Regions	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
Andalusia	1,239	0,638	0,201	-0,038	-0,170	0,053	0,037	0,154
Aragon	0,882	0,866	0,130	-0,032	-0,031	-0,045	0,030	0,117
Asturias	0,827	1,178	0,118	-0,018	-0,154	0,042	0,016	0,083
Baleares	0,510	0,904	0,353	-0,042	-0,194	0,016	0,039	0,057
Canary Islands	0,985	0,768	0,174	-0,041	-0,024	-0,067	0,038	0,117
Cantabria	0,611	1,187	0,160	-0,024	-0,130	0,004	0,021	0,073
Castile and Leon	1,196	0,856	0,089	-0,025	-0,017	-0,040	0,023	0,156
Castile-La Mancha	0,916	0,787	0,071	-0,024	0,123	-0,185	0,022	0,168
Catalonia	1,280	0,547	0,279	-0,037	-0,260	0,132	0,038	0,149
Valencia	1,087	0,612	0,230	-0,038	-0,156	0,037	0,037	0,128
Extremadura	0,548	1,073	0,040	-0,012	0,093	-0,129	0,009	0,124
Galicia	0,948	0,804	0,238	-0,044	-0,119	0,003	0,041	0,108
Madrid	1,093	0,525	0,481	-0,041	-0,207	0,082	0,041	0,098
Murcia	0,729	0,674	0,460	-0,061	-0,088	-0,058	0,056	0,084
Navarre	1,188	0,755	0,190	-0,047	0,022	-0,113	0,044	0,121
Basque Country	1,086	0,675	0,214	-0,037	-0,137	0,028	0,035	0,122
La Rioja	1,466	0,870	0,091	-0,031	0,137	-0,205	0,029	0,133
Average	0,976	0,807	0,207	-0,035	-0,077	-0,026	0,033	0,117
Spain <sup>1</sup>	1,066			-0,037	-0,143	0,063	0,035	0,127
Standard deviation <sup>2</sup>	0,0200	0,0218	0,011	0,001	0,008	0,008	0,001	0,002

Notes: <sup>1</sup>The elasticities for Spain are obtained as weighted averages, taken as weights the ratios of the regional value of the variable to the national value.

<sup>2</sup>Standard deviation of the sample mean.



**Figure 2-** Shadow price and user cost of private capital. Spain 1980-1993.



**Figure 3.-**Optimal and observed private capital stock. Spain 1980-1993.

Given the previous results, it is also possible to reconsider the complementary and/or substitutable relationship between public infrastructures and variable inputs. Apart from the direct or short run effect dealt with in the preceding paragraphs, there will be an indirect effect on the demand of variable inputs. This indirect effect may be generated by the influence of public capital on the demand of private capital, which in its turn would generate additional demand of the other inputs. As can be seen in column

5, once we take into account both direct and indirect effects in the long run labor and infrastructures are substitutes in all the Spanish regions (with four exceptions). The most noticeable result is that in the five biggest regions (Madrid, Catalonia, Valencia, Andalusia and Basque Country) the long run elasticity of labor to public capital is lower than in the short run. The reason is that new infrastructures supplied by the public sector in the long run will generate additional demand for private capital, which further generates new demand for labor. Finally, in the long run intermediate inputs and public capital are substitutes in eight regions and complements in the remaining nine, although among the latter there are the biggest ones.

The last information displayed in table 6 refers to the output elasticities of private and public capital (cols. 7 and 8). The average output elasticity of private capital in the long run shows reasonable values around 0.12; being approximately four times higher than the one corresponding to public capital (0.035). As can be appreciated the elasticity of public capital to output is higher in the long run than in the short run, and the regional pattern of these elasticities confirms previous findings about the regions where infrastructures have the biggest productive effect. Nevertheless, given that in general we have found a high rate of return to public infrastructures in Spain, it seems reasonable to have an idea of their optimal level and where they should be located.

Throughout the paper we have considered public capital as an unpaid input for the firms. However, to be more precise about the productive profitability of public infrastructures we should compare the short run shadow price of infrastructures with some measure of the social user cost of them. To do this we will use three different measures of the social user cost of infrastructures. First, we consider a zero social cost of public capital investment. Second, we use the user cost of public capital available on our database<sup>24</sup>, that has no variation across regions, given that the cost of opportunity which the public sector faces when allocating money to infrastructures is the same no matter what region the money goes. Third, we will consider as an upper bound to the

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<sup>24</sup> The user cost of public infrastructures available in the BD.MORES database is negative until 1984, while it is positive and grows steadily from 1985 to 1993. In real terms the regional average is 0,0576 if we do not consider the first five years, while it is 0,0187 if we consider the complete time span. We will not take into account the negative figures in our calculations.



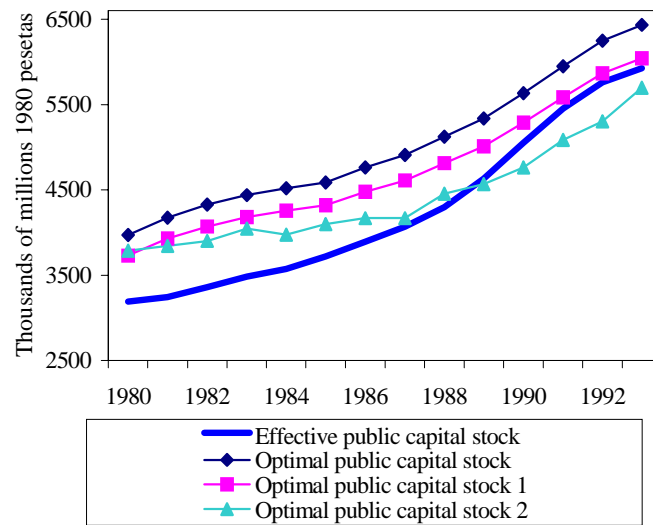
social cost of infrastructures the user cost of private capital for the whole Spanish private productive sector.

In figure 4 we have depicted the time evolution of the stock of effective public capital, as well as the optimal stock obtained by means of equation (11) under the different assumptions about the social user cost. The initial endowment of infrastructures in 1980 was clearly insufficient; no matter what users cost is used as reference. Nevertheless, at the end of the sample period both the optimal and the effective capital stocks have approached considerably<sup>25</sup>, reflecting the enormous investing effort carried out by the public sector in these years. Hence, investment in public infrastructures has been very important, although it is still insufficient, if we take into account that the regions that have more weight in total Spanish gross output have the higher shadow prices of public capital in the long run.

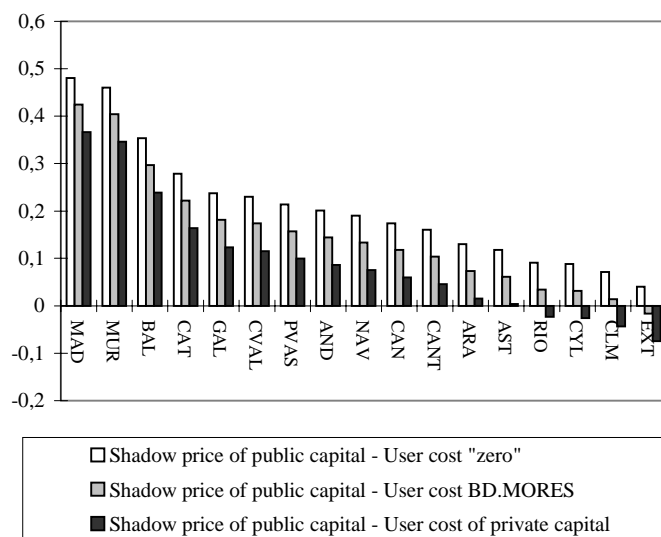
With regard to the optimal placing of public infrastructures, the results across regions obtained for the long run shadow price of public capital (col. 3 of table 6) show that the most profitable regions are Madrid, Murcia, Baleares, Catalonia, Galicia, Valencia and Basque Country. In figure 5 we have ordered the regions in terms of the differences between the long run shadow price of public capital and the different user cost measures. In almost every case, it would be efficient that the public sector provides the regions with higher levels of public infrastructures. If we consider the upper bound case (i.e. the user cost of private capital) there are four regions (Castile and Leon, Castile-La Mancha, la Rioja and Extremadura) where the allocation of new infrastructures would be not profitable. Nevertheless, we must bear in mind that this valuation of productive profitability of infrastructures responds only to efficiency criteria, and ignores equity or welfare issues that the public sector should also take into account.

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<sup>25</sup> If we look at the optimal public stock obtained using the private user cost as reference, it is inclusively lower than the effective one at the end of the sample period. Nevertheless, the utilization of the user cost of private capital is just an upper bound, given that the rate of depreciation of public capital is lower than that of private capital and prices of both of them are different.



**Figure 4.** Optimal public capital stock and effective capital<sup>26</sup>.  
Spain 1980-93



**Figure 5.-** Localization of infrastructures. Average values 1980-1993

<sup>26</sup> Optimal public capital stock, optimal public capital 1 and optimal public capital 2 denote the optimal public capital levels computed under different assumptions about the user cost of public capital. First, we assume a zero user cost of public capital; second, we consider the user cost of public capital in the BD. MORES; and finally we use the user cost of private capital.

## 5. Conclusions.

In this paper we have dealt with the effect of infrastructures on cost performance and productivity of the private sector in the Spanish regions. Our choice has been a dual approach based on cost functions, unlike the majority of studies on the Spanish regions that estimate production functions. Using such an approach we are able to process more information, although we can also recover the conventional parameters obtained from the estimation of production functions. In addition, we also obtain at the regional level cost-benefit measures and elasticities of the various productive inputs, as well as the complementary and substitutable relationship among them. In our framework we allow for the existence of quasi-fixed or external inputs, that may not be at their static equilibrium levels.

The estimation of a Generalized Leontief Cost Function together with the equations that derive from the theoretical restrictions imposed by Shephard's Lemma, allows us to test whether private factors are at their optimal demand levels. In this sense, the tests statistics indicate clearly that labor and intermediate inputs are pure variable inputs, while private capital is a quasi-fixed factor, that is away from its static equilibrium level. This is an important result, since it is commonplace in the literature to impose either that private capital is a variable or a quasi-fixed factor without any formal econometric test that supports one or the other view. If common economic sense may be sometimes enough to impose some theoretical restrictions in our case both aspects work in the same way.

From the econometric analysis in previous pages it is possible to come to some conclusions about the effects of public and private capital on the structure of costs and productivity of the private sector in the Spanish regions along the 1980-93 period. In relation to the shadow price or gross rate of return of both factors, it is worthwhile mentioning that we have found positive and significant shadow prices of private capital in all the regions. Further, the shadow price of private capital is higher than the user cost in those regions that have more specific weight in Spanish total gross output throughout the period. This means that the cost elasticity of private capital is negative in the aforesaid regions and positive in the remainder, which implies also that the optimal stock of private capital is above the effective one in these regions. In almost every

region, investing in new units of private capital seems to contribute positively to job creation and to a saving of intermediate inputs.

The general panorama seems to be different with regard to public infrastructures. The shadow prices of public capital are positive and significant in all the Spanish regions (with the outstanding exceptions of Castile and Leon and La Rioja). Furthermore, unlike the average shadow price of private capital which shows a slight upward trend, the average public capital shadow price shows a clear downward trend throughout the period. This trend implies that the government has reduced, at least partially, the shortage of infrastructures that the Spanish productive sector had at the beginning of the eighties. Nevertheless, there is still margin for the public sector to make further investing efforts, especially if we take into account that the long run shadow prices of public capital (*i.e.* once private capital is at its optimal level) are still positive and high in the most productive regions.

With regard to the complementary and substitutable relationships between infrastructures and other inputs, in the short run the results are more heterogeneous than in the case of private capital. Nevertheless, employment and infrastructures are substitutes, and intermediate inputs and infrastructures are complements in the biggest regions. However, if we take into account that the optimal stock of private capital depends on the existing volume of public capital, it is also possible to study the relationship between them. In our case we have found that both factors are unambiguously complementary in all the Spanish regions (the average elasticity of optimal private capital to infrastructures is 0,81). In other words, infrastructures generate a significant positive impact on the shadow price of private capital, favoring its accumulation in the long run.

## 6. References

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## Appendix

**Table A.1. Estimated structural coefficients.**

Parameter	Coefficient	t-ratio	Parameter	Coefficient	t-ratio
$\alpha_{11}$	-0,359	-5,273	$\gamma_{1tP}$	-0,052	-5,372
$\alpha_{12}$	0,119	5,606	$\gamma_{1YG}$	-0,3 $10^3$	-6,097
$\alpha_{22}$	1,090	14,70	$\gamma_{1tG}$	0,038	1,954
$\delta_{1Y}$	0,2 $10^3$	7,988	$\gamma_{2YP}$	-0,9 $10^4$	-2,084
$\delta_{2Y}$	-0,1 $10^3$	-3,381	$\gamma_{2tP}$	0,010	0,888
$\delta_{1t}$	0,003	0,270	$\gamma_{2YG}$	0,6 $10^3$	10,53
$\delta_{2t}$	0,021	1,448	$\gamma_{2tG}$	-0,091	-3,464
$\gamma_{1yy}$	-0,3 $10^7$	-7,494	$\gamma_{1PG}$	0,313	3,911
$\gamma_{1yt}$	0,5 $10^5$	3,338	$\gamma_{1PP}$	-0,526	-12,82
$\gamma_{1tt}$	-0,7 $10^3$	-0,415	$\gamma_{1GG}$	0,316	1,554
$\gamma_{2YY}$	0,5 $10^8$	1,054	$\gamma_{2PG}$	-1,107	-12,87
$\gamma_{2Yt}$	-0,1 $10^4$	-5,744	$\gamma_{2PP}$	0,926	22,57
$\gamma_{2tt}$	0,003	1,708	$\gamma_{2GG}$	1,481	6,372
$\delta_{1P}$	1,130	12,459	$D_1\alpha_{11}$	0,005	1,930
$\delta_{1G}$	-0,769	-6,299	$D_1\alpha_{22}$	-0,006	-2,616
$\delta_{2P}$	-1,203	-11,77	$D_2\alpha_{11}$	-0,010	-2,940
$\delta_{2G}$	0,373	2,555	$D_2\alpha_{22}$	0,040	13,22
$\gamma_{1YP}$	-0,6 $10^4$	-1,727			
R <sup>2</sup> Cost Function			0,941		
R <sup>2</sup> Labor Demand			0,743		
R <sup>2</sup> Intermediate Inputs Demand			0,613		
R <sup>2</sup> Equation Price = Marginal Cost			0,981		
Schankerman and Nadiri test $\chi^2$ (10) = 8186,438 (P-Value = 0,00000)					
Shephard Lemma test $\chi^2$ (36) = 22,9628 (P-Value = 0,95482)					
Test of the Curvature condition for K <sup>*</sup> <sub>P</sub> : $\gamma_{1PP} + \gamma_{2PP} = 0,40$ $\chi^2$ (1) = 3,7482 (P-Value = 0,05286)					
N° Obs. 238					