Chapter 12

Crowding-Out Effect in the European Union and Candidate Country Turkey: Panel Causality Analysis

Binhan Elif Yılmaz
İstanbul University, Turkey

Ferda Yerdelen Tatoğlu
İstanbul University, Turkey

Sinan Ataer
İstanbul University, Turkey

ABSTRACT

The effects of the government investments and private sector investments on the production, is an important academic argument subject between the Neo-classical school and the Keynesian school. Subject to the financing way of the government sector investments, accruing possibility of private sector investments decreases and crowding-out effect occurs with the behaviours of government sector which restricting the investment area of private sector or changing the investments plans. On the other hand Keynesian economist suggest that the economy is not always in the full employment level. By the hand of Keynesian multiplier mechanism which is increasing the public expenditures and decreasing the taxes, private sector would enhance its investments and crowding-in effect occurs. In this study, we aimed to test the existence of crowding out/in effects of the public sector investments on the private investments in the European Union and a candidate country Turkey with the panel causality tests, over the period 1970-2014.

DOI: 10.4018/978-1-5225-2245-4.ch012
INTRODUCTION

Investments are in the center place of capital accumulation. Capital accumulation is the most important and the most strategical factor of the economic growth with a qualitatively and quantitatively sufficient population and technological development. Private sector investments are the essential determinant of long term economic growth and for the expansion of production capacity, from the point of view of Neo-Classical thought.

In the countries which adopted the mixed economy, both of public sector and private sector are each producers and consumers in the economic and social life and have their own decision and choice possibilities. These two sector sometimes became opponent for each other or sometimes became component of each other in their activities. Therefore, determining the relationship between public and private sectors as the most accurate form, measuring the effects of them on each other and maintain the relationship between these two sector in a regular way, are important in terms of economic growth.

There are positive effects of public sector investments on the private sector investments. Public investment expenditures are able to increase the productivity of private sector investments. Especially, implementing the important infrastructure investments by the hand of government is an “invitation” for the private sector investments. The investments of public sector which are directed to the Human capital have an effects on the increasing the factor productivity. By that way, a complementary relationship occurs between these two type of investment expenditures. In this case an increase in the public expenditures enables an increase in the private investments. Besides, public sector supplies the public goods which are not proper to leave to the hand of private sector as defense and justice services and generates important positive externalities.

The economic rationale behind most of these studies resides in the idea that public sector investment is confined, by and large; to those goods and services that the private sector investment will not produce in optimal amounts, because it is both hard to ration their use and benefits to paying customers (the free rider problem) and they are subject to substantial short-up costs. These public goods are subject to substantial start-up costs. These public goods are, nevertheless, of critical importance to the proper functioning of a market system because they tend to generate large and widespread spillover benefits (Ramirez, 1994: p. 6).

However, public sector investments may crowding-out private investments if the relationship between them is based on substitutability. Hence, the relationship between public sector investment and private sector’s productivity may provide additional information about the relationship between public spending and private investment.

According to Neo-Classical perspective, subject to the way of financing the public investment expenditures, increases in the government investments can occur a crowding-out effect on the private sector investments. This crowding-out effect realizes directly or indirectly. The increases in the taxes because of enhancing government investments, restrict the fiscal and physical sources of private sector investments. In that case there is a competition between public sector and private sector and direct crowding-out effect occurs.

As a results of implementation of public investment expenditures in the fields which are also the activity area of private sector, government investments will be subsidied and acting without efficiency. (Ramirez, 1994: p. 6). In the scope of producing competitive products with the private sector, crowding-out effect deepens.