

How Productive is Public Investment? Evidence from Indian Manufacturing

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Abstract

This paper uses firm-level data on formal and informal production in the manufacturing sector in India to examine the sectoral consequences of government investment in public infrastructure. While public investment has a strong and positive association with the productivity of formal sector firms, it has no systematic association with the output of the average firm in the informal sector. Using a major highway construction project in India as a natural experiment, we show that the productivity benefits from public investment are evenly distributed across firm size in the formal sector. By contrast, they are strictly increasing in firm size for the informal sector. As such, larger firms in each sector tend to crowd out the output of smaller informal firms, mitigating the overall benefits of public investment for the informal sector.

JEL Classification: E2, H4, H5

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