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The Impact of Transaction Costs on Economic Growth a Statistical-Mathematical Analysis

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Abstract

The presence of substantial levels of transaction costs represents an important barrier to the development of nations and regions. In this manuscript, the authors present a new version of the neoclassical model of economic growth that incorporates the ex-ante and ex-post transaction costs (namely, those borne to negotiate the contractual terms and hedge against the loss caused by the unfair behavior of the counterparty). The model's solutions indicate that the capital market can fail when the economic agents are exposed to significant transaction costs, with dramatic consequences on welfare. The authors evaluate the predictions of their theoretical setting by using time-series data ranging between 1995 and 2021 regarding the economy of the Italian Mezzogiorno, a historically lagging-behind territory characterized by low social capital and (consequently) high transaction costs. Their empirical analysis consists of assessing the beta-convergence and sigma-convergence hypotheses through a Hamilton regime-switching model accounting for transaction costs. The obtained evidence demonstrates that the higher the transaction costs, the lower the ability of the Mezzogiorno's economy to converge to its steady-state equilibrium and reduce inequality with the richer regions of northern Italy. The authors use their findings to provide policymakers with valuable advice on how to favor the long-run development of the Mezzogiorno's economy.

Keywords: Economic development, Italian Mezzogiorno, Regime-switching models, Regional Economics, Quantitative methods in Economics