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The UK's infrastructure arms race leads us down a road to nowhere

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When a political consensus arises, it's usually time to worry. Right now, the Conservatives and Labour have convinced most commentators that ramping up government infrastructure investment is an economic no-brainer.

Clear differences exist in the scale and composition of the parties' plans. Chancellor Sajid Javid has pledged an extra £22bn per year of borrowing for new public investment in road, rail and broadband. Labour's John McDonnell wants to more than double current investment spending, adding £55bn a year primarily for "green" and "social" transformation.

Both, ultimately, would raise public investment to levels not seen sustainably since at least the Seventies, predicated on the idea that cheap borrowing costs make today a great time to invest.

Economists have legitimised this reasoning, after strongly opposing investment cuts in the early 2010s. But there's an essence of fighting yesterday's war here. The economic case for infrastructure spending is very different when we're close to full employment than in a recession rebound. No longer do we desire mythical "shovel-ready projects" putting unemployed construction workers back to productive activity.

With unemployment low, infrastructure spending will take resources, workers and capital out of the private sector and into politically managed enterprises. For this to be an economic boon requires such spending to be more socially productive than the private activity it replaces.

No economist would disagree that good infrastructure can enhance economic potential, in theory. A new road that cuts travel time between two cities reduces the effective cost of production, delivery and movement of workers, raising profit and encouraging entry into the local market.

Better connections allow more specialisation, improved job matching to skills and the building of more meaningful economic clusters. Where the worry creeps in is over whether the political process ensures the right investments are made, and cost effectively.

An early warning sign comes from the claim that low interest rates make today a good time to invest. Such reasoning only considers the "cost" side of a project and not the benefits. If interest rates are low because growth is weak, then user numbers for road, rail or broadband will be lower too, reducing its social returns. Borrowing costs tell us nothing about a project's desirability alone. More instructive is the lack of private sector appetite for the projects politicians desire.

Nor does it follow that cheap government borrowing makes government infrastructure the most desirable response. Suppose some private projects generate an average 5pc return on capital and a government project only generates a 3pc social return.

At borrowing rates of 1.5pc, it might be preferable for the economy to engage in deficit-financed business tax cuts, such as full expensing of investment in plant, buildings and machinery within the corporation tax system, to encourage the activities with the biggest economic payoff.

Low borrowing costs are therefore a red herring. What matters is whether government investments have bigger net social benefits than if workers, machines and capital were retained privately. Claims that new government infrastructure investment will be “good for the economy” hinges on Javid and McDonnell knowing better how to generate productivity improvements than businesses and entrepreneurs, perhaps by selecting projects that alleviate genuine market failures or deliver huge bang for the buck.

Chalk me up as unconvinced. Politicians historically prefer prestige projects and unveiling plaques over maintenance or removing bottlenecks that tend to generate big returns. How else to explain that in the 2010 spending review, the Coalition government deferred and cancelled road projects with average benefit-cost ratios of 6.8 and 3.2, respectively, but pushed ahead with HS2, then estimated to have a benefit-cost ratio of just 1.2?

Bent Flyvbjerg’s magisterial work has shown that over-optimism plagues political megaprojects worldwide. Nine of every 10 major projects have cost overruns, commonly of 50pc or more. Rail projects, he finds, are especially characterised by over-optimism on user numbers. Little surprise then that huge infrastructure spending drives have ended in tears, from Spain’s empty airports to China’s ghost cities. Japan, in particular, has invested like crazy for three decades, to little avail.

Javid and McDonnell’s specific investment priorities heighten doubts about a growth dividend. Conservatives prioritise economic infrastructure, true, but their 3pc of GDP annual investment target is arbitrary. A political focus on “left behind” regions suggests the investment will work against market signals rather than with them.

The party’s obsession with broadband is based on speculative technological determinism too – a blind faith that it is a “must have” because computers are important. Given faster broadband roll out could occur privately and profitably to most areas, the Government would, in effect, be throwing billions of pounds to ensure relatively remote areas are connected, with unclear economic benefits.

The sheer scale of Labour’s spending plans make them susceptible to dodgy investments (the UK would be the highest spending advanced economy). McDonnell admits he prioritises “green” and “social” transformation, not growth. But building social housing, rather than removing barriers to a responsive private housing market, could lock people into unproductive areas.

Though climate change deserves a response, rapid decarbonisation would push the UK into expensive forms of renewable energy, without much affecting global emissions. Other social investments will try to revive flagging regions. Yet previous attempts at regeneration, not least under Gordon Brown, failed miserably.

Anyone expecting this infrastructure arms race to address Britain’s chronic productivity problem will thus be disappointed. Well-targeted infrastructure projects selected according to disciplined cost-benefit analysis could enhance growth in areas where private provision is impossible. With the outright deluge of funds proposed, mixed with politics, such requirements speak for themselves.

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