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Road to nowhere: we cannot dig, build, or pave our way out of economic malaise

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"THERE IS NO MORE persistent and influential faith in the world today than the faith in government spending," wrote economist Henry Hazlitt in his classic book Economics in One Lesson. Our economy is doing poorly; the government can fix it. Our roads are crumbling; the government can fix them. Better still, according to the faithful, pouring money into roads, bridges, rails, buildings, and high-speed Internet lines will fix our economic problems and create jobs.

American public works are hardly in perfect condition, and economists have long recognized the value of infrastructure. Highways, bridges, airports, and canals are the conduits through which almost all goods are transported. But the kind of infrastructure spending the government has been indulging in since 2008 is unlikely to produce much of a stimulus--certainly nothing with the scale and speed the administration is banking on as the 2012 elections approach.

The economist Mark Zandi of Moody's Analytics, one of the most influential stimulus enthusiasts out there, claims that when the government spends $1 on infrastructure, the economy gets back $1.44 in growth. But economists are far from a consensus about the returns on federal spending. Some find large positive multipliers (meaning that everydollar in government spending generates more than a dollar of economic growth), but others find negative multipliers (meaning every dollar in spending hurts the economy). As Eric Leeper, Todd Walker, and Shu-Chum Yang put it in a recent paper for the International Monetary Fund, "Economists have offered an embarrassingly wide range of estimated multipliers."

An additional complication is that, according to stimulus advocates such as former Obama administration adviser Larry Summers, spendingis stimulative only flit is timely, targeted, and temporary. Currentstimulus spending on infrastructure isn't any of those things, as I found in a recent paper co-authored with my Mercatus Center colleagueMatt Mitchell.

By nature, infrastructure spending fails to be timely. Even when the money is available, it can take months, if not years, before it isspent. That's because infrastructure projects involve planning, bidding, contracting, construction, and evaluation. According to the Government Accountability Office, as of June 2011 only 62 percent ($28 billion) of

Department of Transportation infrastructure money from the 2009 stimulus had actually been spent.

The only thing harder than getting money out the door promptly is properly targeting spending for stimulative effect. Data from Recovery.gov, the administration's online clearinghouse for information about stimulus spending, shows that stimulus money in general and infrastructure funds in particular were not targeted to those areas with thehighest rates of unemployment. Keynesian theory of the type many in the Obama administration favor holds that the economy can be stimulated best by employing idle people, firms, and equipment.

Even properly targeted infrastructure spending may have failed to stimulate the economy, however, because many of the areas hardest hitby the recession were already in decline. They were producing goods and services that are not, and will never again be, in great demand. The demand for more roads, schools, and other types of long-term infrastructure in fast-growing areas is high, but these areas are more likely to have low unemployment relative to the rest of the country.

Perhaps more important, unemployment rates among specialists, suchas those with the skills to build roads or schools, are often relatively low. And it is unlikely that an employee specializing in residential-area construction can easily update his or her skills to includebuilding highways. As a result, we can expect that firms receiving stimulus funds will hire their workers away from other construction sites where they were employed, rather than plucking the jobless from the unemployment rolls. This is what economists call "crowding out." In this case labor, not capital, is being crowded out.

New data from Garett Jones of the Mercatus Center and Dan Rothschild of the American Enterprise Institute show that a plurality of workers hired with stimulus money were poached from other organizations rather than coming from the ranks of the unemployed. Based on extensive field research--more than 1,300 anonymous, voluntary responses frommanagers and employees--Jones and Rothschild found that less than half of the workers hired with stimulus funds were unemployed at the time they were hired. Most were hired directly from other organizations, with just a handful coming from school or outside the labor force. So much for putting idle resources to work. Jones adds that during recessions most employers who lose workers to poaching choose not to fill the vacant positions, leaving unemployment essentially unchanged.

There is no such thing as temporary government spending, which stimulus spending needs to be in order to work. Infrastructure spending in particular is likely to cost the American people money for a very long time. The stimulus was layered on top of the $265 billion average annual expenditure on infrastructure and capital investments and the $2.9 trillion nominal increase in infrastructure spending during the last 10 years.

What are we getting for all that money? Waste, for one thing. Infrastructure spending tends to suffer from massive cost overruns, fraud, and abuse. A comprehensive 2002 study by Danish economists Bent Flyvbjerg, Mette K. Skamris Holm, and Soren L. Buhl

examined 20 nations on five continents and found that nine out of 10 public works projects come in over budget. Cost overruns routinely range from fro percentto 100 percent of the original estimate. For rail, the average cost is 44.7 percent greater than the estimated cost when the decision wasmade. The figure is 33.8 percent for bridges and tunnels, 20.4 percent for roads.

According to the Danish researchers, American cost overruns reached $55 billion per year on average. This figure includes famous disasters such as the Central Artery/Tunnel Project (CA/T), better known asthe Boston Big Dig. By the time the Beantown highway project--the most expensive in American history--was completed in 2008, its price tag was a staggering $22 billion. The estimated cost in 1985 was $2.8 billion. The Big Dig also wrapped up seven years behind schedule.

Strangely, lawmakers are blindsided by these extra costs every time--even when the excesses take place under their noses. Take the Capitol Hill Visitor Center in Washington, D.C. This ambitious three-floor underground facility, originally scheduled to open at the end of 2005, was delayed until 2008. The price tag leaped from an estimate of $265 million in 2000 to a final cost of $621 million. How can eyewitnesses to this waste still believe such spending is good for the economy?

The biggest mistake made by infrastructure spending enthusiasts isto assume that it is the role of the federal government to pay for road and highway expansions in the first place. In a 2009 paper, Cato Institute urban economist Randal O'Toole explained that, with very few exceptions, roads, bridges, and even highways are inherently local projects (or state projects at most). The federal government shouldn't have anything to do with them.

Taxpayers and consumers would be better off if these activities were privatized. If states are not ready for privatization, they can dowhat Indiana did a few years back, when it granted a 99-year lease for its main highways to a private company for $4 billion. The state was $4 billion richer, and it still owned the highways. Consumers in Indiana were better off, because the deal saved money and the roads got better since the private company committed to spending $4.4 billionin maintenance. Experience in other countries has shown that privatization leads to more construction, innovation, and reduced congestion.

A certain amount of public spending on public works is necessary to perform essential government functions. But federal spending on roads, rails, and bridges as a means of providing employment or creatingeconomic growth is an expensive fantasy.

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