The Daily Dish

The (Yuuuge) Infrastructure Genie

DOUGLAS HOLTZ-EAKIN, PATRICK HEFFLINGER | OCTOBER 28, 2016

On Wednesday the Securities and Exchange Commission (SEC) unanimously voted to approve two new rules aimed at making it easier for small companies to raise investor capital. Rule 147A will allow small businesses to avoid SEC registration thereby alleviating many compliance costs which were found to be overly burdensome to small businesses. Rule 147A will go into effect in 150 days.

Yesterday the Federal Communications Commission (FCC) voted to approve a new rule aimed at giving consumers more control of how internet service providers use their personal information and data. The new rules state that internet service providers will need their customers' permission to use data that the FCC has deemed "sensitive." The final rule is in line with the proposal released earlier this year by FCC Chairman Tom Wheeler.

Yesterday The American Action Forum (@AAF) released an analysis highlighting the strategic benefits of passing the Trans-Pacific Partnership (TPP). The analysis finds that TPP would revive U.S. economic influence in the Asia-Pacific and strengthen America's leadership worldwide. AAF President Doug Holtz-Eakin also released a video explaining the strategic importance of TPP which can be viewed here.

Eakinomics: The (Yuuuge) Infrastructure Genie

'Tis the season when nominees' minds turn to chocolate, cotton candy, and … concrete; you know, handouts you can promise to citizens in exchange for their votes. Who would have anticipated that the campaign would feature the Infrastructure Genie — that magic spending which will create jobs, boost productivity, improve growth, and is free!

Hillary Clinton has promised $250 billion in direct infrastructure spending and another $25 billion as seed money for an infrastructure bank. Unsurprisingly, the left greeted this with glee and slippery economics. Paul Krugman, in particular, argued "Put these two facts together — big needs for public investment, and very low interest rates — and it suggests not just that we should be borrowing to invest, but that this investment might well pay for itself even in purely fiscal terms. How so? Spending more now would mean a bigger economy later, which would mean more tax revenue. This additional revenue would probably be larger than any rise in future interest payments." As we shall see, this does not make sense.

Donald Trump's plan, however, puts this fantasy on steroids. Advertised as "The Trump Private Sector Financing Plan", the plan is quite simple in its construct: (1) provide roughly $140 billion tax credits to equity investors in public-private infrastructure projects, (2) leverage the projects at a ratio of 5 to 1 (i.e., $833 billion in debt), and (3) spend $1 trillion dollars on public infrastructure. But the *coup de grace* is the assertion that taxes on the labor income and profits from the projects will cover the tax credit subsidies. It's free!

It is also nonsense. First, every infrastructure plan is financed by the private sector; indeed, every dollar of government spending comes from the private sector. That is true for Trump, Clinton, or anyone else.

Second, the question is not whether an infrastructure project generates returns large enough to attract capital market financing. The question is whether those returns are higher than investment in the private sector. If not, every dollar taken away from private investment and plowed into infrastructure is an economic step in the wrong direction.

Third, recall that the U.S. economy is basically back to full employment so that the only way for it to grow is to increase either the number of workers or their productivity. This proposal does not increase the number of workers. Imagine, for the moment, that it does not increase productivity. If so, the wages and profits earned on these projects come by shifting activity from some other part of the economy. That is, the taxes on these wages and profits will be offset by taxes lost on other wages and profits. The Infrastructure Genie cannot simply manufacture money.

Infrastructure can raise productivity; my modest estimate is that $100 billion raises Gross Domestic Product (GDP) by $5.4 billion. Thus, the Trump plan would produce $54 billion in GDP that, if taxed at an effective rate of 20 percent, would yield about $11 billion annually. That's real money in some circles, but not enough to balance the subsidies.

Fourth, and most important, is the fact that these projects would have to be associated with a revenue source to generate the cash to pay off investors and lenders. The Trump architects acknowledge this, but miss the point. Those user fees, tolls, and other prices are the most important part of a infrastructure plan. If people are not willing to pay the toll, the road should not be built. If tolls flow in steadily, the road may be maintained or expanded. In short, using price signals tells us which infrastructure is valuable, which is not, and how much of it to build. The point is not to pick some silly, large, arbitrary number. The point is to make sure the optimal number of infrastructure projects are built — and the rest are left behind.

There is no Infrastructure Genie. Instead, there are serious infrastructure needs that are being greeted by non-serious proposals. Have another glass of milk and a manhole cover.