The Daily Dish

CBO, Infrastructure, and Growth

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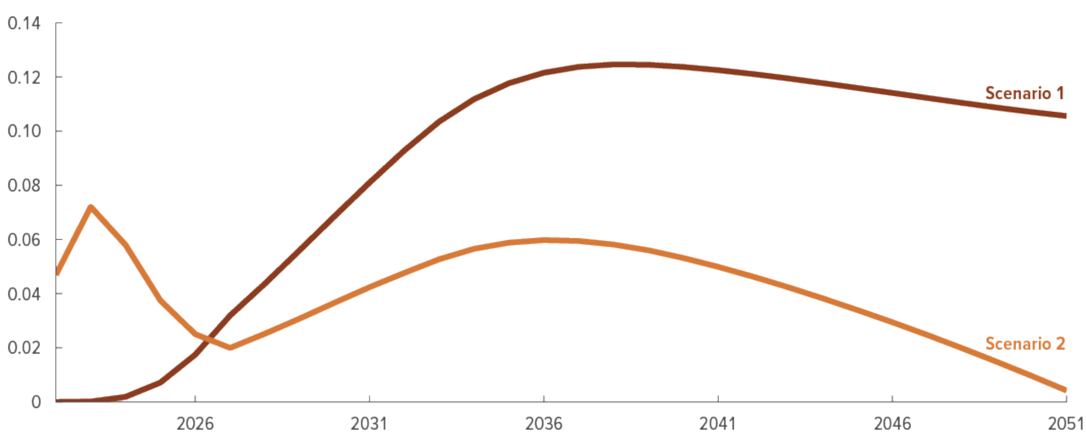
Eakinomics: CBO, Infrastructure, and Growth

As the Senate grinds toward a vote for passage of the bipartisan infrastructure legislation, the Congressional Budget Office (CBO) released an aptly named study: "Effects of Physical Infrastructure Spending on the Economy and the Budget Under Two Illustrative Scenarios." Of note, this is not an analysis of the bill (or any other legislation), but it does shed some light on the macroeconomic issues in play.

The CBO looks at two stylized polices. In both, infrastructure spending is increased by $50 billion per year for 10 years – $500 billion in new spending. In one case ("Scenario 1"), the spending is offset by reductions in non-investment spending so that the deficit does not widen. In the second case ("Scenario 2") , the new spending is financed by borrowing. Notice that Scenario 1 is roughly the original intent of the drafters of the Bipartisan Infrastructure Framework (BIF) – core infrastructure spending paid for by cuts in other spending and no new taxes – while Scenario 2 is the extreme version of what some critics complain about the final product.

To cut to the chase, the chart below (taken directly from the CBO study) summarizes the impacts on real gross domestic product (GDP). Switching the mix of spending toward investment has permanent beneficial impacts on the level of economic activity. Debt-finance has a sugar-high impact in the near term, but the long-term impact is essentially nil.



A key feature is that deficits reduce funds available for private, productivity-enhancing investments over the long term. CBO estimates that "an additional dollar's worth of private fixed capital increases real potential GDP by 15.6 cents and that the net effect is 9.8 cents, accounting for a 5.8 percent depreciation rate of private capital." Crowding out investment to cover additional debt loses these benefits. Notice, in contrast, that "CBO estimates that an additional dollar's worth of infrastructure capital increases real potential (maximum sustainable) GDP by 12.4 cents, on average. Using the 3.2 percent depreciation rate for public capital, the net effect is an increase of 9.2 cents."

In other words, on average private investment is more productive than infrastructure investment. This is the right way to think of the tradeoff from increasing federal infrastructure investment – the loss of private investment. Notice, in particular, that it has nothing to do with federal borrowing costs, which is how it is often incorrectly framed.

Obviously, the desirability of the legislation is in the eye of the beholder because it is a policy mixed bag. That was inevitable from the start because a commitment to bipartisan politics means a commitment to policy compromise and the reality that the final bill will contain components that either side will dislike. But the choice is not between Scenario 1 and 2; it is between this legislation and nothing at all.