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RESEARCH SUMMARY

# WOULD MORE INFRASTRUCTURE SPENDING STIMULATE THE ECONOMY IN 2017?

President-elect Trump has made rebuilding America's infrastructure an important part of his policy agenda. Specifically, Mr. Trump has called for a $1 trillion infrastructure spending package, which proponents claim will spur economic growth and create thousands of jobs. Yet historically, attempts at using infrastructure spending as economic stimulus have fallen far short of expectations.

In the updated Mercatus Center study "Would More Infrastructure Spending Stimulate the Economy in 2017?," Senior Research Fellows Veronique de Rugy and Matthew D. Mitchell review the literature on infrastructure spending as a fiscal stimulus. The authors find significant reasons to doubt the effectiveness of fiscal stimulus, particularly at this time, and they note that infrastructure projects are particularly ill-suited for stimulus. The study concludes that, as a short-term measure, more deficit-financed federal infrastructure spending is unlikely to stimulate economic growth. Over the longer term, however, it is certain to leave the United States deeper in debt with little meaningful improvement in growth.

## FINDINGS

In an effort to boost employment and economic activity, fiscal stimulus aims to replace private spending with government spending during an economic crisis. There are significant limitations to this approach, however, especially given the current macroeconomic environment in the United States:

- *The fiscal multiplier*. The multiplier measures the effectiveness of government spending in expanding the economy. Many studies find a very small multiplier for stimulus spending, especially when macroeconomic conditions resemble those currently seen in the United States. In fact, some studies find this spending actually shrinks the economy.

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- *Lack of idle resources*. Fiscal stimulus aims to put idle resources back to work. However, the potential benefits to the current US economy are small given that unemployment is low and interest rates are poised to climb.

- *Permanence*. Like most "temporary" spending, stimulus spending has been shown to remain in the budget, and add to the debt, long after the targeted crisis has passed.

The key conditions necessary for infrastructure spending to act as fiscal stimulus have been repeatedly proven unlikely to occur:

- *Timeliness*. Even when the money is available, it can be months, if not years, before it can be spent on a "shovel-ready" project, as infrastructure projects tend to involve a lengthy planning and implementation process.

- *Poor targeting*. Infrastructure spending is seldom sent to areas hardest hit by the recession or used for projects with the highest value added, thus greatly limiting its ability to spur economic growth. Further, infrastructure projects generally employ specialists who do not suffer from high unemployment, so infrastructure spending seldom creates a significant number of new jobs or reduces overall unemployment.

The long-term value of federal infrastructure projects is dubious. Federal policymakers lack the incentives and information required to make good investment decisions, leading to numerous problems:

- *Cost overruns*. Nine out of ten transportation infrastructure projects come in over budget, with overruns routinely varying between 50 and 100 percent of the original budget.

- *Misestimating demand*. There is a systematic tendency to overestimate potential rail infrastructure usage, as well as new projects' return on investment. Nine out of ten rail projects overestimate actual traffic, and 84 percent of these projects are wrong by more than 20 percent. Road projects, meanwhile, tend to underestimate traffic, meaning that they underestimate the financial costs and overestimate the congestion-reduction benefits of roads.

- *Failure to maintain*. There are strong political incentives to focus infrastructure spending on high-profile public works, rather than on fixing bridges and filling potholes—which would be more beneficial.

- *States spending federal dollars*. As most infrastructure spending decisions are made at the state and local levels, federal financing puts local elected officials in the position to spend money unwisely, as they will have little accountability for their decisions.