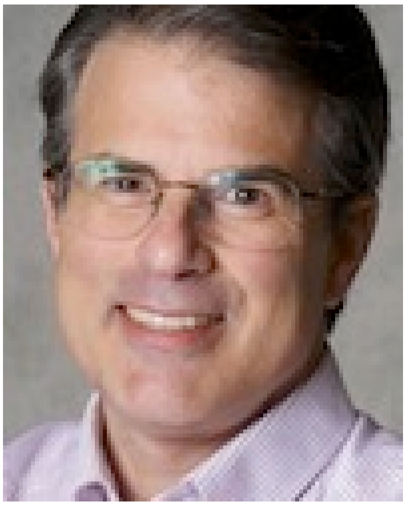
The Trade-Offs of a Big Spend on Infrastructure

By Kerry Pechter *Thu, May 13, 2021*

Finding money for Biden's infrastructure plan will be easier than finding the human and physical resources to do it, and easier than agreeing on what to give up to free-up those resources.



Economists and pundits have been arguing over whether the Biden infrastructure plan would be inflationary or not. Advisers wonder what to tell clients about taxes and volatility. US equities fell about 4% in the first three days of this week. We're money people so naturally we're interested in the money aspect of the plan.

I like the infrastructure goals: I believe the environment is in jeopardy and that we have to deal with it. I don't expect the private sector to solve that problem. But I wonder about public-sector the execution skills. Democrats are rushing to pass a big appropriations bill before the 2022 mid-term elections. Infrastructure renewal will take patience.

The infrastructure bill, I have **read**, calls for spending $200 billion per year for 10 years. The money, if appropriated, will probably take decades to spend. Its cost will be financed over a longer period. Even the smallest projects will require needs-assessments, prioritization, environmental impact studies, competition, bids, and so on.

Information about infrastructure has so far come mainly from lawyer-legislators who know little about hydrology, material science, optical fiber networks, or power grids. Are Pete Buttigieg, Jennifer Granholm, Marty Walsh, who run the Transportation, Energy, and Labor departments, respectively, getting briefed by civil engineers? I don't know.

The big questions are the similar to those in wartime: Where will the human and material resources come from? What purchases or activities might we have to give up to supply those resources to the effort? Exactly what categories of manufacture will we have to put on hold, or abandon, in order to renew infrastructure? Or are there enough idle human and material resources in the US today to accommodate Biden's vision?

Those are worthwhile macroeconomic questions. The current quarrels over the precise definition of "infrastructure" might be an encoded debate on that point. Otherwise they seem infantile.

The financial markets may need Uncle Sam to spend big. As long as we insist on using arbitrary growth conventions like “compound interest” and mark-to-market” pricing of every share of stocks–which cripple debtors and create shaky towers of paper wealth—then the government has to supply more money. Where else will it come from?

Since we use so much private leverage, we can’t afford big markdowns in the value of collateral. We’ve needed the Fed to support asset prices with low interest rates and quantitative easing. With the world economy so reliant on dollars, we need even more of them. Otherwise we’ll have to tolerate more crashes, busts, deflation and episodes of mass unemployment; the bottom half will suffer disproportionately.

Mainstream macroeconomics predicts dire consequence for debt-financed government spending. In 2016, the Congressional Budget Office **studied** the impact of federal spending in general and reported:

“Increased federal borrowing reduces the amount of money available for private investment—a phenomenon called crowding out. CBO’s central estimate is that for each dollar that the federal deficit increases, domestic private investment falls by 33 cents. That reduction in private investment results in a smaller capital stock, eventually shrinking output. Similarly, a reduction in federal borrowing leaves more money available for private investment, resulting in a larger capital stock and eventually greater output.”

Since we insist on lower taxes, and we don’t want to borrow, then government can’t spend on infrastructure. And it can’t force the private sector to drop what it’s doing and focus on cooling the planet. That’s a recipe for doing nothing, which seems childish. Adult think ahead, children don’t. That the biggest difference between them, as far as I can tell.

What about the “crowding out” problem. If the CBO’s statement implies that government borrowing will crowd out demand for private debt, reduce the appetite for shares of stock, and reduce the amount of lending that banks will need to do, then it makes sense. There’s reason to believe that the payroll tax and the Social Security system, for example, crowd out the demand for private investments and annuities. Public finance competes with private finance. Demand for private sector credit—and bank revenue–would presumably drop if the government issues trillions of dollars in grants. The banks aren’t likely to stand for that.

But that doesn’t say that the public and private sectors compete in a zero-sum game for a finite pool of dollars. If they did, Fed policy of the last 12 years would have, in effect, exhausted the nation's supply of drinking water by turning its liquidity hose on financial fires.

Our monetary system is demonstrably more flexible than that. The federal government spends money into existence and banks lend money into existence. Borrowing, taxing, and the gathering of personal savings doesn't necessarily precede that process. To smooth over mismatches in the supply of money, the public and private financial sectors cooperate. The banks accommodate the Treasury's need for liquidity. The Fed accommodates the banks' need for liquidity. A snake-eating-its-tail system would have collapsed a long time ago.

After I lost my job in the financial crisis of 2009, I looked for the license plate number of the truck that hit me. I'm still trying to get a clear description of it.