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Learning from Japan: Infrastructure Spending Won't Boost the Economy

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As the U.S. economy continues to deteriorate and has now entered a recession of uncertain magnitude, many in Congress, the media, and the business community are pushing for a bold federally funded stimulus package that they claim will create jobs, raise incomes, and put the economy back on its path of positive economic growth. Not surprisingly, much of this advocacy stems from a nostalgic embrace of President Franklin Delano Roosevelt's New Deal, implemented in the early 1930s in a failed effort to end the Great Depression that had its origin in the stock market collapse of October 1929.

Related to this sentimental longing for New Deal authenticity is the revival of the teachings of John Maynard Keynes, who postulated in his 1935 *The General Theory of Employment, Interest and Money* that "There is room…to promote investment and, at the same time, to promote consumption, not merely to the level which with the existing propensity to consume would correspond to the increased investment, but to a higher level still."[1] Subsequent generations of elected officials throughout the world took this observation as a license to raid their treasuries, and no country could be sorrier for endorsing a primitive version of Keynes's teachings than the Japanese—who squandered vast sums of national wealth in a vain attempt at stimulus that cost them the chance to lead the world in economic growth and prosperity.[2]

New Deal Back in Vogue

Here in America, federal officials and lobbyists have raced back in time to embrace their own retro-

Talking Points

- Congressional plans to spend more than $500 billion on a federal stimulus package to revitalize the U.S. economy would most likely backfire and make the economic situation worse.
- Independent studies of past U.S. government stimulus spending have found that such spending had little or no positive impact.
- Massive spending increases under the New Deal did not end the Great Depression; World War II ended it.
- Attempts by the Japanese to spend their way out of a recession beginning in the early 1990s contributed to a reduction in Japan's economic growth and a decrease in its level of prosperity.

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Keynesian kitsch by passing H.R. 7110, the Job Creation and Unemployment Relief Act of 2008, in September. The Congressional Budget Office (CBO) estimates that this bill will cost $58.2 billion between 2009 and 2013.

More recently, President-elect Barack Obama announced his intention to propose a stimulus package composed of spending increases and tax reductions that may total between $500 billion and $1 trillion and that will include a substantial amount of money for infrastructure, an inexact term that includes the physical assets upon which everyone depends: telephone poles, school buildings, roads, electric wires, power-generation plants, waste-water treatment facilities, grist mills, reservoirs, etc. This focus stems in part from a belief that much of our infrastructure has deteriorated and that a substantial investment in it is essential to long-term growth and prosperity while also providing jobs and profits in the present.

Not surprisingly, trade associations that represent road, rail, and transit builders and operators have been aggressive in their advocacy of more infrastructure spending, promising tens of thousands of new jobs and vastly improved service in the future. The media have also joined in; *The New York Times*'s Paul Krugman was one of many to make this case for more infrastructure spending when he urged recently that "[f]iscal expansion will be even better for America's future if a large part of the expansion takes the form of public investment—of building roads, repairing bridges and developing new technologies, all of which make the nation richer in the long run."[3]

Little Impact on Jobs or Growth

As The Heritage Foundation has noted in earlier reports, past infrastructure spending—especially related to transportation—has little to show in terms of countercyclical stimulus or job creation.[4] Much of this lackluster impact stems from the long lag time involved in getting such spending programs up and running, as well as the propensity of the state and local governments to substitute federal money for already-committed state and local money in order to shift such funds to other purposes.[5]

In this regard, trade associations like the American Association of State Highway and Transportation Officials, which contend that there are more than 3,000 transportation projects ready to get started within 30 to 180 days, are most likely referring to projects that are already funded. In this time of need, no sensible state government would waste the considerable costs associated with planning, permitting, engineering, and management in getting projects "ready to go" unless there were funds already available to start—and complete—them.

In making his pitch for more spending, Mr. Krugman perhaps anticipates that critics of his spending scheme might cite the example of Japan, whose reliance on bold infrastructure spending in the early 1990s led to the squandering of so much money on so many wasteful projects that the country soon slipped from one the world's most prosperous nations to the status of a middling also-ran that has yet to recover from its mistake. Krugman attempts to create a parallel to New Deal timidity by arguing that "[i]n 1996–97 the Japanese government tried to balance its budget, cutting spending

1. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: A Harbinger Book, 1964 edition), p. 325.
2. Ronald D. Utt, Ph.D., "Lessons on How NOT to Stimulate the Economy," Heritage Foundation *Backgrounder* No. 1495, October 22, 2001, pp. 3–6, at *http://www.heritage.org/Research/Budget/BG1495.cfm*. See also Amity Shlaes, "The Perils of a Cement Tsunami," *The Washington Post*, December 10, 2008, p. A25. at *http://www.washingtonpost.com/wp-dyn/content/article/2008/12/09/AR2008120902785.html*.
3. Paul Krugman, "Deficits and the Future," *The New York Times*, December 1, 2008, at *http://www.nytimes.com/2008/12/01/opinion/01krugman.html?pagewanted=print* (December 16, 2008).
4. Ronald D. Utt, Ph.D., "More Transportation Spending: False Promises of Prosperity and Job Creation," Heritage Foundation *Backgrounder* No. 2121, April 2, 2008, at *http://www.heritage.org/Research/budget/bg2121.cfm*.
5. *Ibid.*, pp. 6–7.

and raising taxes. And again the recession that followed led to a steep fall in private investment."

The Japanese Experience

In fact, Japanese fiscal policy during the 1990s was flamboyantly unrestrained, and during that decade no other advanced industrialized country had expanded government spending by nearly as much. Starting in 1991, government spending (outlays) in Japan accounted for just 31.6 percent of the nation's GDP—one of the lowest among members of the Organisation for Economic Co-operation and Development (OECD).[6] That year also marked the high watermark of Japanese prosperity: In 1991, Japan's per capita gross national income (as adjusted for purchasing power parity) reached 86 percent of the U.S. gross national per capita income, compared to the 66 percent Japan had reached in 1970—a remarkable achievement that only tax- and budget-cutting Ireland has achieved since then.

As the decade of the 1990s wore on, many other countries—especially in Europe—were paring back government spending to spur growth, but Japan was doing just the opposite. By 2000, its government outlays had jumped to 38.3 percent of GDP, while Canada had reduced its government's share from 52.3 percent in 1991 to 41.1 percent, and the United Kingdom had gone from 44 percent to 37.5 percent, to cite just a few of the many developed nations that were actively shrinking government over that period to bolster their private sectors.

While Krugman is correct in noting that Japan cut back spending in 1997 (to 35.1 percent from a 36.4 percent share of GDP), it soon shot up to around 38 percent, where it remains today. As a 2001 Heritage Foundation report noted, a substantial portion of Japan's stimulus spending was focused on infrastructure:[7]

> Beginning in 1991–1992, Japan adopted the spending approach now advocated by many in the U.S. Congress when it embarked on a massive nationwide program of infrastructure investment. Between 1992 and 2000, Japan implemented 10 separate spending stimulus packages in which public infrastructure investment was a major component. Excluding the 2000 program, for which final costs are not yet available, additional spending on the infrastructure component alone amounted to 30.4 trillion yen, or $254 billion at the current exchange rate.

Cutting spending seems not to have deterred prosperity in most of the European countries that have done so since 1990, while the relative prosperity of the Japanese has been on the decline as government spending has advanced. After peaking at 86 percent of U.S. income in 1991 and 1992, Japanese income continually fell behind the U.S., and by 2000, Japan's per capita gross national income had fallen to 73.7 percent of that of the U.S. despite the increased spending stimulus in Japan during the 1990s and into the 2000s. This decline in relative performance reflects the fact that the Japanese economy grew at an annual rate of only 0.6 percent between 1992 and 2007. In 1991, only the United States, Austria, and Switzerland had higher per capita incomes than Japan. By 2006 (the most recent OECD numbers), Japan's per capita income was surpassed by Austria, Australia, Belgium, Canada, Denmark, Finland, Ireland, Holland, Switzerland, Sweden, and the U.S.[8]

Conclusion

Although the benefits of a costly, infrastructure-focused stimulus package based on massive government spending may be intuitively attractive, past evidence suggests that the impact of govern-

6. All subsequent data on incomes are from Organisation for Economic Co-operation and Development, *OECD Factbook 2008: Economic, Environmental and Social Statistics—ISBN-92-64-04054-4*, "Macroeconomic Trends—Gross Domestic product (GDP)" and "National Income Per Capita (U.S. dollars, current prices and PPPS)," while data on government spending shares come from *OECD Economic Outlook 77*, Annex Table 25: General Government Outlays.
7. Utt, "Lessons on How NOT to Stimulate the Economy," p. 3.
8. Luxembourg and Norway are excluded from these calculations because of anomalous economic factors that distort their data relative to those of other advanced nations.

ment spending programs that are intended to encourage economic growth is very modest and unlikely to enhance recovery or deter recession. As noted above, the Japanese government implemented such a program during the 1990s, and the consequence was two decades of economic stagnation. Less ambitious infrastructure stimulus programs have been implemented in the United States over the past few decades, and numerous independent and government studies have concluded that these programs had little impact on economic activity or jobs.

It is worth remembering that the New Deal of the 1930s substantially and permanently increased the scope of the federal government as Congress and the President attempted to spend their way out of the Depression. After the stock market collapse in 1929, the Hoover Administration increased federal spending by 47 percent over the following three years. As a result, federal spending increased from 3.4 percent of GDP in 1930 to 6.9 percent in 1932 and reached 9.8 percent by 1940. That same year—10 years into the Great Depression—America's unemployment rate stood at 14.6 percent.

It is important to recognize that our infrastructure and the continued investment in it are important underpinnings of future economic growth and sustained prosperity. But it is equally important to recognize that the long-term nature of these benefits to cost-effective mobility and quality services, and the need to choose carefully among competing options and technologies, suggests that a stimulus scheme based on spending is ill-suited to the short-term stimulus needs that are of concern to policymakers. Given current congressional practices, any stimulus package approved by Congress is certain to contain a host of projects that have nothing to do with prosperity and everything to do with political influence and current fashion.

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