Summarising and signposting essential reading we've seen elsewhere...

THE CHINA SYNDROME

Does infrastructure investment lead to economic growth or economic fragility?

It is often claimed that public infrastructure spending is desirable because it has positive spillovers – such as lower transport costs and increased productivity – which make the social benefits of such expenditure higher than the private benefits.

China is held up as an example, having seen double-digit growth rates in infrastructure investment in recent years, alongside very high rates of GDP growth.

However, the effectiveness of Chinese infrastructure spending has seldom been tested empirically. This paper examines 95 road and rail projects undertaken in China between 1984 and 2008. The authors seek to estimate how many of the projects, once completed, were of net economic benefit.

They find that 75 per cent of the projects suffered cost overruns, and that half encountered a schedule delay. This is a better performance than Western countries – where 70 per cent of infrastructure projects suffer delays – but the authors speculate that incentives in China may be such that project managers are encouraged to work quickly at the expense of road safety and environmental impact. It is worth noting that China has one of the highest road fatality rates in the world, at 18.8 deaths per 100,000 inhabitants per year.

When it comes to project benefits, the authors find that the average traffic shortfall against forecast was only 5 per cent. However, the average conceals the wide discrepancy between individual projects: 64.7 per cent had traffic starkly below forecast – with their average shortfall at 41.2 per cent – whilst the remaining 35.3 per cent had excess traffic averaging 61.4 per cent, which led to congestion.

A project is judged to be of net economic benefit if it has a benefit-cost ratio (BCR) in excess of 1 – meaning, quite simply, that the benefits exceed the costs. The authors find that 55 per cent of the projects studied had a BCR below 1. Given uncertainty over project operation and maintenance costs, they calculate that only 28 per cent can be considered of genuine economic benefit.

The paper concludes that the link between Chinese infrastructure spending and economic growth is weaker than often assumed. Furthermore, it argues that heavy infrastructure spending has contributed to increasing macroeconomic vulnerability.

China's ratio of total debt to GDP has reached 282 per cent, dangerously high for a middle-income country with an ageing population. Much of this is public debt or debt from state-owned entities such as banks.

Combined with massive monetary expansion, heavy indebtedness could make a potential future crash deeper and more prolonged.

ANSAR, A., B. FLYVBJERG, A. BUDZIER and D. LUNN

Oxford Review of Economic Policy 32(3): 360-390, 2016

STEELY RESISTANCE

Industrial policy and downstream export performance

The use of industrial policy to promote targeted domestic industries fell out of favour in much of the West from the 1980s, as empirical evidence showed that state subsidies and trade protectionism made industries less efficient and raised costs for consumers.

However, in recent years industrial policy has seen a revival, exemplified by calls in Europe and the United States for protective tariffs against Chinese steel imports and by the creation of a Department for Industrial Strategy following the Brexit vote.

Whilst advocates of industrial policy often point to the presumed benefits that intervention may have

RED TAPE TANGLE

Labour market regulations and capital intensity

Microeconomic theory suggests that labour market regulation which raises the cost of employment – such as statutory pay floors, limits on working hours and rules on the scope and duration of work contracts – will lead employers to substitute capital for labour.

Substitution may have a differential impact according to skill levels, with low-skilled workers more vulnerable to replacement by capital than high-skilled workers.

This paper tests the hypothesis empirically by examining a panel of 14 OECD countries between 1988 and 2007. The sample includes both countries where employment markets are tightly regulated, such as France and Spain, and those that are relatively more liberal, such as Britain, Denmark and the United States. The authors analyse data across a range of manufacturing and service industries.

The paper finds that employment protection legislation is associated with higher capital-to-labour ratios. Importantly, capital intensity in both R&D – where labour costs are a large share of total costs – and ICT are negatively associated with labour market regulation. Increased labour market regulation tends to lower the capital share in research and information technology.

Overall, increased labour market regulation is associated with a higher share of high-skilled employment in total employment and a lower share of low-skilled employment. This may be because capital is primarily a complement to high-skilled labour whilst it acts as a substitute for low-skilled workers. Of course, if low-skilled workers are made unemployed then the share of high-skilled workers will increase.

The authors then estimate the impact of a hypothetical labour market liberalisation programme.

They define liberalisation as closing the gap with the level of regulation that exists in the United States, which has the least restrictive employment legislation according to the OECD.

Liberalisation would increase the share of low-skilled employment in total employment and lower the high-skilled share, though the effects are more complex in R&D and ICT sectors. All of these effects would be particularly pronounced in the high-regulation economies.

The paper underscores the paradox of employment protection legislation, which ostensibly aims at protecting the most vulnerable workers, but which may in fact worsen their employment outcomes.

Whilst the authors do not examine the impact of regulation on total employment, the high-regulation countries in their sample exhibit consistently higher unemployment rates – particularly among the young – than more liberal economies.

CETTE, G., J. LOPEZ and J. MAIRESSE
NBER Working Paper 22603. Washington, DC: National Bureau of Economic Research, 2016

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on targeted sectors, it is important to examine the effect of such policies on the economy as a whole.

This paper estimates the impact of industrial policies targeting the steel industry – including import tariffs, government ownership, cartelisation, price controls, non-tariff barriers and subsidies – on the export performance of domestic users of steel, such as the construction and manufacturing sectors. The author uses a sample of 22 countries from 1975 to 2000.

There is wide variation in the number of interventions applied in each of the countries studied, ranging from two or fewer in America, Canada and New Zealand, to more than five in Italy, Belgium and France. The paper also documents a general decline in the use of industrial policies from the mid-1980s.

The author finds that steel interventions perceptibly affect the export performance of downstream producers.

Specifically, his estimates suggest that a one standard deviation increase in industrial policy is associated with a 1.2 per cent decline in exports for the average steel-using firm in that country, a decline which is as high as 6 per cent for those sectors which are heavy users of steel. These negative results are driven by the performance of developing countries.

When further tests are performed, the paper finds that Germany, Belgium and the Netherlands also exhibit significant harmful effects from steel intervention on export performance.

Two interventions are found to be particularly harmful to exporting industries, namely steel export subsidies – which raise the domestic price of steel since steel producers forego the subsidy when they sell domestically – and government ownership of the steel sector, which could lead to inefficient and costly production.

BLONINGEN, B
The Economic Journal 126(595): 1635-1659, 2016.