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**Infrastructure for
Employment's
sake ?**

This issue is an unashamed polemic.

(Wikipedia: a polemic text on a topic is often written specifically to dispute or refute a position or theory that is widely viewed to be beyond reproach.)

I have touched on this issue briefly in the last few issues but have been encouraged by readers to treat it with the seriousness that it deserves.

This is THE most important short run issue that we face today as asset managers. Unless you happen to be in a region that is unaffected by the downturn in economic activity, you need to know - and what is more, you need to *take action!*

If you don't, you will end up with assets that contribute little to community service but take a lot from your budget, making it even harder to do your job in future. On a wider scale, failure to deal with this issue now will make it much harder to deal with long run issues such as global warming, diminishing oil and water reserves, population ageing, etc. later.

If you AGREE with me - tell me what you, and others, can do

If you DISAGREE with me - tell me why

Just, please, do not sit on the fence!

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Editorial

There is a great difference between building *required and justified* infrastructure in slow economic times - with the desirable by-product of generating employment and to choose infrastructure *simply* for its employment generating aspects. One is a TIMING issue. The other is MADNESS.

Let me tell you a true story.

A Fable for Our Times

There once was a small island where a number of the people were unemployed.

The Chief decided to build infrastructure 'to create employment'. The policy worked very well, people were employed building the new works and they were happy. The Chief was held in high regard. When the infrastructure projects were completed however the people stopped being happy and looked for new jobs, and so the Chief built more infrastructure.

To finance this infrastructure he borrowed money. The island's debt started to increase. This would not have been a problem if the infrastructure had generated revenues sufficient to pay off the debt but the unemployment occurred in the north of the island so the infrastructure was built there, but most of the island's population lived in the South, where infrastructure could have been better used to generate income.

Each year the Chief borrowed more and more, and created more and more infrastructure. Then one day the Chief was defeated on the political field of battle and a new Chief was installed. The new Chief looked at the accounts and saw they were not good. Projections of the future debt liability showed that if the island were to continue to borrow at the rate it had been doing, *in just a few years all of the island's revenues would be needed just to pay the interest bill!*

The new Chief had to quickly put in place serious recovery measures. They were not liked by the people, even though they knew that they now had no options. Going broke was clearly an unsustainable position.

Others started to raise serious questions about whether the island could be trusted to run its own affairs, and to suggest that maybe it should be taken over by its better managed neighbours. Bankruptcy was averted by stringent measures but the people went through a very painful time of readjustment that lasted for many years as a result of 'living beyond their means'.

ARGUMENTS FOR

Every good lie has a kernel of truth and every wrong community conviction has at its kernel a hope and a wish. Let's examine some of these hopes and wishes.

- **Generates employment**

Yes it does.

*But ANY government expenditure at this time does. It is the *spending*, not the *infrastructure* that creates employment. And other spending may generate more employment that is better targeted and better timed, since infrastructure planning is rather slow and unpredictable.*

- **Low opportunity costs**

Yes, this is true. If government spending puts people into jobs who otherwise would be drawing on unemployment benefits, then the *net* cost to the taxpayer is lower.

But the spending must be carefully targeted to generate work that can be done by those out of work - not to increase the demand for, and therefore the salaries of, those who already have work! In general, the simpler and less skilled the job, the greater the opportunity for absorbing those who are out of work. Some jobs inherently need to be done 'on site' and generate jobs here. Others can be bought in. So if the aim is to reduce local unemployment, government should look to those jobs that are done here (services, maintenance). On the other hand, if we are altruistic and want to look to the needs of overseas countries that may be even worse off than we are, then infrastructure that requires lots of imported items would be the way to go.

- **No 'crowding out'**

In times of high demand - as we have experienced recently when government demand for infrastructure competed with the demand for skilled resources needed by the resources boom - economists speak of the problem of government demand 'crowding out' needed private sector investment. In times of low demand, there is no 'crowding out'.

- **Build now so that the infrastructure is there and ready when the economy improves.**

This is good if we know now when the downturn will be over and what the needs will then be

But if we don't, and if the world is rapidly changing, we could easily end up building for yesterday's needs - and make the recovery even slower!

MORE ARGUMENTS FOR



Ripple Effects and Bottlenecks

It is often argued that the creation of new infrastructure, say a highway, will make it possible for new industries to set up, creating more jobs, and for new subdivisions to develop, again creating more jobs. There is some truth to this, but the key word is 'possible'.

Critically unless there is underlying demand for the new industries and new subdivisions that is being held back by the lack of enabling infrastructure, none of this will happen - you will just have an expensive new highway. (And we generally find pent-up demand in growth times, not in periods of low employment!)

cf ““Removing infrastructure bottlenecks is seen as a good business opportunity by private players. The [infrastructure] sector is emerging as a potential employment generator with its share set to leap further,” Assocham President Sajjan Jindal said.” This is in fast growing India! Bottlenecks are not an issue in low growth times.



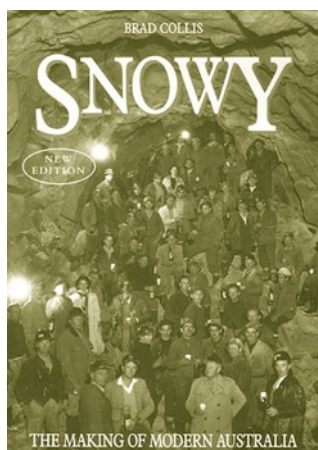
Public Infrastructure encourages private infrastructure

This is a related argument. It draws some strength from academic studies that showed a positive relationship between infrastructure spending and output - from which the erroneous conclusion was drawn that infrastructure spending automatically increases productivity and output.

But as you know a positive correlation does not imply causation. In the case of public and private infrastructure a much more likely reason is that they were both related to a third factor - expectations. When the government expects demand to increase they will construct infrastructure to meet it. When the private sector expects demand to increase they will build capacity to meet it. (However, as above, this happens in growth times, not when employment is low.)

In fact, economic studies of the length and timing of trade cycles show that the larger the capacity overhang the longer it takes for the private sector to recover. Maybe the same is true of the public sector?

OK. IF BUILDING INFRASTRUCTURE IS NOT THE EMPLOYMENT GENERATING PANACEA CLAIMED - WHY DO SO MANY PEOPLE THINK IT IS?



The answer to this may be history.

Our early infrastructure was typically large scale and dumb! By this, I mean that the main requirement was for unskilled labour - and lots of it! Think digging out tunnels for the Snowy Mountains Hydro Electric Scheme, or before that the Overland Telegraph, the large overland pipelines like Kalgoorlie or the Mannum to Adelaide, even the Sydney Harbour Bridge. Or think Burma Railway!

These projects were huge, they took a lot of labour, and a lot of time. Much of it was men with pickaxes. Simple tasks that could be done by migrants with little knowledge of the local language (or, in the case of the railway, little willingness for the task). But they were not done to create employment, rather for the value of the finished product.

They also opened up a continent, making things possible that weren't possible before. These large schemes are the stuff of dreams. The BBC produced a documentary series called the "Seven Wonders of the Industrial World" and the ABC a documentary series on "Constructing Australia". They make wonderful stories. I have both sets of DVDs and have watched them several times. When you watch them you stand in awe not only of the genius of the lead engineers and designers, but also of the ordinary man who worked (and sometimes died) in great numbers to produce these wonders.

It is not surprising then that they have created the infrastructure employment myths that are part of our folklore. And not only for us in Australia, but in other countries also.

But today is different

And today's infrastructure is different. Today's infrastructure is much more high tech. It requires skilled technicians more than unskilled labour. It is also smaller in impact.

The basic, large scale, upstream, relatively simple, infrastructure structures that we associate with our pioneering past are now in place. We can move on. Today's infrastructure is likely to be smaller and smarter, and privately provided and user funded. It is heavy on negotiation and intelligence and correspondingly lighter on brute force and construction activity.

And let us not forget the role of the media!

INFRASTRUCTURE FOR EMPLOYMENT'S SAKE

When we build infrastructure **primarily** for the purpose of employing people, we

build the wrong infrastructure

in the wrong place

- and we make the unemployment problem worse!

Danger point: *When the arguments that “and it will create x jobs” - is the strongest argument for the project, you have problems!*

Wrong infrastructure, in the wrong place

The purpose of infrastructure assets - *any* asset - is to provide service! If the asset is justified on the basis of service provision, then building it in times of high unemployment is a good TIMING decision rather than a REASON for the infrastructure itself.

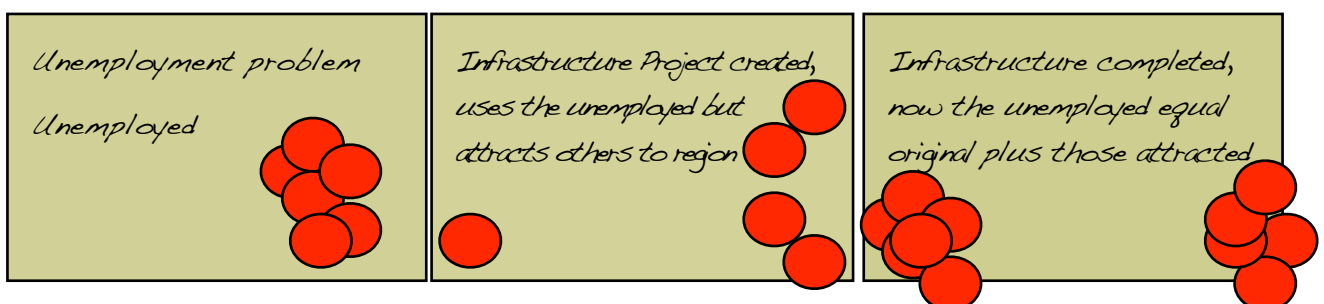
But what if we choose the type of infrastructure service to suit the resources available? It used to be the case that every State Government had its own public works department. If the department had a lot of carpenters, we would create carpentry jobs; if we had a lot of painters, then we would do painting jobs. And if there were a lot of unemployed in the country areas, we would look to country infrastructure. Infrastructure was SUPPLY driven. It wasn't chosen for service provision, it was chosen to occupy the resources we had available.

Gradually we came to realise that this was exceedingly unproductive and costly. We looked for ways to put the focus on DEMAND rather than supply. At this time, many governments disbanded their public works forces. It was a brutal response, and probably over the top, but the supply driven infrastructure practices were so ingrained it required a big shift in thinking to get it to change.

The point is that infrastructure for employment's sake is just more of this same devalued supply-side thinking!

And it makes 'the unemployment problem' worse! How so?

Now more people are in a region incapable of providing sufficient employment for them!



WHAT CAN ASSET MANAGERS DO?

1. Resist the temptation to take the money and run! There will be some of you who won't care what the money is to be spent on, as long as it is infrastructure and therefore subject to your control. But I hope that among SAM readers, there are not too many like that.

Remember that every piece of infrastructure, every asset, you acquire now will cost you in the longer term - in staffing, security, cleaning, lighting, etc - and maintenance. Since extra maintenance money rarely comes along with new infrastructure, this will mean that you have to make your limited budget go even further! Your job will therefore get harder. Put the effort in now and resist assets that don't pay their way in increased productivity and service.

2. Make clear the longer term impacts of all proposed 'infrastructure for employment's sake' projects. Discourage them.

This is best done by itemising and detailing the ongoing life cycle costs. Talking in generalities will not be anywhere near as effective here. Talk in terms of *what else has to be given up* to manage the future life cycle costs of the new asset.

3. Plan ahead! When Governments have money to hand out, have good quality infrastructure projects ready to run.

Don't wait until the money is in your hands for you will certainly be required to spend it faster than you can decide on the most effective projects and how to do them. - and be forced to waste the money on the first opportunity that comes to hand.

4. Speak up in wider community forums. You don't have to be the CEO to do this. Anybody can.

Remember if those who know, don't say, and those who say, don't know - we get the worst of possible outcomes. The media is full of 'opinion' - supply some facts!

5. Tell your friends, neighbours, colleagues.

The reason why the 'infrastructure is good for employment' myth continues is because we haven't taken the trouble so far to correct it.

SUMMARY

Remember - if you agree with me, please give me your ideas on how the issue can be addressed and corrected; if you don't agree with me, tell me why. We need you!

Arguments for:

Generates employment - yes it does, but other government spending can do more

Low opportunity costs - yes, indeed, if spending is correctly targeted to unemployed

No 'crowding out' - yes again, if spending is correctly targeted to unemployed

Build now to be ready for later - yes, if we can be sure we know how long the current downturn will last and what we will be needing when it is over, doubtful!

Remove bottlenecks and create 'ripple effects' - first establish that you really have a bottleneck and that there is pent up demand ready to utilise the infrastructure created, in the current circumstances, this is also doubtful.

Why do people believe?

The effect of history - and the powerful images of past large projects using masses of unskilled labour, but today is different, infrastructure is smaller, cleverer.

Nobody has told them differently

Infrastructure for Employment's sake creates

Wrong infrastructure

In the wrong place

And makes unemployment worse when the project finishes

What can you, as an Asset Manager do?

1. Resist the lure of 'easy money'
2. Make clear the longer term impacts of proposed projects
3. Plan ahead!
4. Speak up in wider forums
5. Tell your friends, neighbours, colleagues, spread the word!