

Investing can have hidden payoff

4:00AM Wednesday Mar 11, 2009

By [Brian Fallow](#)

The potential uses for some infrastructure may not be dreamed of when the initial investment occurs, so the cost/benefit hurdle may need to be set lower when judging whether to invest in them, argues economist Arthur Grimes.

In a lecture in Auckland yesterday Grimes, senior research fellow at the think tank Motu, said some types of new infrastructure, such as electricity, had very long-lived dynamic impacts.

It was imperative that evaluations of the infrastructure benefits did not restrict their attention just to the reactions of existing firms or residents.

"The effects of the new investment on existing activities may, in fact, be subsidiary to its impacts in drawing forth new, potentially quite different, activities," Grimes said.

The benefits of road-straightening work on a rural highway were quite easily foreseen, in terms of faster travel times and fewer deaths and injuries.

"By contrast, investment in fast broadband for some regions may have a payoff through making viable new sectors or firms that are currently not even in existence," he said.

The discount rates chosen when undertaking cost/benefit analyses should reflect those differences.

Grimes cited several studies which support the claim that public spending on infrastructure in the 1990s and early 2000s was low by international standards.

Looking at investment spending between 1970 and 2005 as a share of gross domestic product, he said private sector expenditure on plant and machinery was between 11 and 14 per cent for most of that period – above the OECD median. By contrast the Government investment ratio averaged about 8 per cent between 1971 and 1986, and only half that since then.

Grimes also outlined work he and colleagues at Motu had done on the importance of regulatory arrangements on the returns to infrastructure investment, specifically Auckland's metropolitan urban limit, and water allocation in Canterbury.

"Auckland's metropolitan urban limit has had a clearly discernible impact in preventing development along much of the path of the new Northern Motorway extension. Indeed, this is consistent with the expressed purpose of the MUL," Grimes said.

"What is not clear is whether the lost development benefits are outweighed by greater benefits elsewhere for the region."

In Canterbury's Mackenzie district the irrigation infrastructure had positive effects for many farms.

"However, many other farms that could benefit from a water right have no water consents and, in most circumstances, cannot easily obtain water from those with a water right." Water trading could produce better outcomes.