

How good is public capital investment?

There is in the UK debate a general assumption that all capital investment is good. It is true that the UK could boost its productivity – and therefore its incomes – by investing in more machine power, internet processing power and the like. The more people have better tools to do their jobs, the more they can produce and deliver to customers. This is the main reason people automatically assume investment is a good idea.

Not all capital spending achieves this aim. Public investment in particular may not achieve this to the extent planned in the way intended. Indeed some desirable public investment is not in anyway about raising productivity. It is about keeping up with the big growth in population we are experiencing.

Capital spending is treated differently from day to day or revenue spending because it is meant to create an asset of value which will be available for use for many years to come. If the state builds a new school, there will be many years of use. The costs of the building can be spread out over many years of teaching by borrowing the money and repaying it gradually. Making such an investment, however, usually increases future costs, as it is usually built to accommodate growth in population and pupil numbers. It is not necessarily going to raise productivity or cut overall costs. Similarly, building a replacement school may be desirable or necessary to provide a better modern environment for staff and pupils. Again it may not reduce annual costs.

In the public trading sector where people pay for use of the service provided there is meant to be a proper analysis of the productivity and revenue consequences of the investment. Unfortunately the public sector often gets its sums wrong. Look at the case of the railways. Commuters often pay the cost of their travel but other railway users are in the main heavily subsidised to go by train. Major investment programmes often fail to raise productivity much, and sometimes fail to capture the extra use and fare revenue they estimated. HS1 has never reached the optimistic forecasts for use, and HS2 looks as if it too will fall well short of the bullish estimates of how many people will use it once built.