

BUSINESS - GOVERNMENT INTERACTION  
REGARDING INVESTMENT DECISIONS

A CHECK LIST

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Regarding Investment Decisions

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In the "good old days" a corporate investment decision could be translated into bricks and mortar with little delay and minor interactions with government to obtain building permits. Usually only one or two government departments were involved and the review process consisted of ensuring conformance with existing regulations.

Today the corporation faces a different environment. Almost any investment is subject to review, usually by several levels of government and often by a number of departments at each level. Furthermore, the review process attempts to alter the private investment plan to conform with a wide variety of social objectives which may be themselves in conflict. The "rules of the game" are continually being rewritten. Although it may be useful to protest the regulatory burden, it is a fact of life that is not likely to wane in the coming years.

## 1. The Research Base

Over the years a number of methodologies, or frameworks, have evolved as part of the review process for private and public investments. Other areas have not yet been systematized but might well evolve in the coming years. With each investment project some or all of the frameworks may be used, each attempting to answer different questions or arraying different information for the public decision-makers. These frameworks are described below, and are grouped under three broad headings - Project Analysis, National, and Regional.

### 1.1 Project Analysis

The frameworks here are normally applied by the corporation although they may be subject to review by governmental authorities.

- 1.11 Engineering and Design - details the physical characteristics of the project, and locational considerations.
- 1.12 Cost Estimates - determination of the costs of investment and operations. Concern with escalation of costs, import content, taxes may be required.
- 1.13 Market/Sales Plan - Projections of volume and prices for outputs of project. Domestic/export mix should be identified.
- 1.14 Investment Analysis Plan - Elements of the marketing and cost studies are brought together and incorporated into a period-by-period elaboration of revenues and costs. Present value calculations are performed to

establish corporate net benefits, internal rate of return, etc. This framework establishes the viability of the investment from the corporate viewpoint. (Depreciation and interest costs are excluded at this stage.)

1.15 Financing Plan - Most projects entail costs before revenues are earned. The financing plan of the project would indicate the sources of financing (debt, equity, internal funds) and the interest payments and debt repayment.

1.16 Financial Plan - With the information from the investment analysis and financing plan, a balance sheet/income statement can be generated to determine the return on equity. At this point depreciation schedules, income taxes, etc. are incorporated. This analysis should be done in current dollars so that taxes, inventories, interest payments, etc. are correctly stated.

## 1.2 National Frameworks

To assess the "value" of the project from a social viewpoint two basic frameworks are used - macroeconomic impact and benefit-cost. Such studies depend on the project analysis plans being in place; usually they are an "integrating" device for these plans.

1.21 Macroeconomic Impact - Using a model of the economy, two forecasts are produced - one with the project and one without the project. Attention is usually focused on the difference between the two forecasts and the concern is to identify the aggregate income, employment, and price effects as well as the impacts on the current account balance, government balances, unemployment rate, corporate profits, etc. A distinction is usually made between direct, indirect, and induced effects meaning the direct expenditures or sales associated with the project, the indirect effects associated with the purchases of goods and services from the suppliers to the project, and the induced effects resulting from the spending of incomes received from the project or from later rounds of spending. The implicit assumption is made that the resources are available and that offsetting government policies are not implemented. In some cases the purpose of the exercise will be to identify potential bottlenecks in the economy; in other cases to assess the positive effects on employment, etc.

1.22 Benefit-Cost Studies - Such studies are similar to the corporate investment appraisal except that all identifiable social benefits and social costs are included. Key areas of concern are the "boundaries"

of such studies, the prices used for valuing benefits and costs, and the valuation of externalities or "side-effects" of the project. It is usually assumed that all resources of the economy are fully employed and the purpose is to determine if the project contributes positive net benefits to the society by redirecting resources towards the project. In essence, the study determines the "efficiency" of the resource allocation implied by the project.

### 1.3 Regional Frameworks

The frameworks discussed above can also be done on a regional basis or with regional disaggregation of the results. But regional analysis is much more than a piece of a macro-economic study. It is likely that a project will entail other expenditures by provincial or local authorities on roads, schools, etc. Some of the "externalities" of the project - environmental effects, strengthened industrial base - will be concentrated in a particular region. It is this concentration of effects that requires regional frameworks of analysis.

1.31 Environmental Impact - Studies to determine the effect of a project on the flora, fauna, and quality of water and air. Approaches and costs of mitigation may be identified.

- 1.32 Economic Impact - Sophisticated models of a region usually do not exist. The methodology employed is to establish a "base-line" view of the regional economy and then to identify the direct economic effects of the project on the region. Procurement practices are obviously important here. Subsequent induced effects or "multiplier effects" are estimated based on the ability of the region to supply additional goods and services. Emphasis is placed on the number of jobs created, additional population base, incomes, and the effect on government expenditures and revenues for the various levels of government involved.
- 1.33 Social Impact - The concern here is with the impact on the people and the local community. In addition to the identification of benefits and costs in the region, it is also the practice to focus on the distribution of benefits and costs. In some cases mitigation of costs is also part of the study. Some practitioners seek substantial participation from interested parties in the community in discussing the social impact; thus there can be an element of "social activism".

- 1.34 Political Impact - Although not an established framework there is no doubt an assessment made of the political ramifications of any project by politicians at every level of government. This may be in terms of the contribution of the project to economic and social policy, the short-term effect on the electorate, the longer term effect of population changes caused by the project on relative party strengths in the region, or the effect on the relative bargaining power of one level of government vis-a-vis another.
- 1.35 Legal Impacts - In some cases, the project may require new legislation or become an implicit party to a legal dispute (e.g., land claims, water rights, etc.). A clear understanding of existing legislation, possible legal wrangles, and requirements for changes to the framework of law should be analyzed with the same care given to other parts of the project.

## 2. Responsibilities

The corporation is usually responsible for the preparation of the project analysis (e.g. engineering studies, financial plan, etc.). But "guidelines" may be imposed here by governments to ensure information necessary for subsequent analyses, comparability with competing projects, etc.

The responsibility for national and regional studies varies substantially. There is an increasing trend towards imposing this responsibility on the corporation, particularly in the case of regulatory tribunals (NEB, AERCB, etc.). In some cases the analysis will also be performed by one or more levels of government.

If there is a choice then the corporation should weigh the advantages and disadvantages of undertaking the various national and regional studies. Some of these are:

### Advantages

1. Ability to define the scope of the study - timeframe, boundaries, depth of analysis.
  2. Ability to control the timing of the studies to coincide with engineering and other project analysis.
  3. Ability to modify studies as project definition changes or to modify project before formal submission to enhance national and regional benefits.
  4. Improvement of project planning since these studies focus on the external circumstances in which the project will occur; helps to identify sources of cost overruns, etc.
- Frequently, these studies are helpful in uncovering internal

inconsistencies between different elements of the project analysis.

Disadvantages

1. Costs of such studies are not trivial.
2. Details of the project may need to be revealed that provide information to competitors or critics. If study was done by government an assumption is acceptable; if the corporation does it then it must be factual.
3. Governments can criticize studies without concern for resource implications of further work. This could lead to even longer approval lags.

3. Other Thoughts

3.1 - Government review of private projects is different from government decision processes about government projects; this difference is not appreciated. For a private project it is necessary that both private and public needs are met. That is, the project must be financially viable to the corporation as well as in the public interest. With a government project it is not necessary that the project itself be viable, but rather that the collective benefits exceed the collective costs. This difference imposes limitations on the governments in terms of their "capture" of benefits or imposition of additional costs on the private project to "internalize" externalities.

3.2 - The undertaking of studies to assist in the governmental decision-making process should be viewed as a bargaining process about who pays for the work, who sets the terms of reference, and, possibly, who takes the responsibility downstream in the event that unanticipated benefits/costs occur. Who ever "owns the study" is likely to bear the "risk" over time.

3.3 - The "activist approach" to social impact has a number of inherent dangers to the corporation. There will be a continual problem of separating those social costs which will occur regardless of the project with those costs attributable solely to the project. If you create a strong awareness of the project's benefits and costs and the project does not proceed then you are likely to be held responsible for raising expectations in the area. This does not mean that the corporation should be mute;

but there is a big difference between communicating information about the project and setting up community action groups to assess/mitigate social effects.

3.4 - Given the "sacrosanct" nature of interfering with the political system, any political impact study is not likely to be publicly disclosed, regardless of who does it. But it is important that it be done, since most projects have long-term lives (20-50 years) which require long-term contracts (explicit and implicit). But political lives may be very short and any effects on the political dynamics of the region are important to understand in determining the political base of support to be sought for the project.

4. Questions Before Starting Business - Government Interaction

- 4.1 Is the project viable? Will it produce substantial net present value at a 10% real discount rate?
- 4.2 What are the jurisdictions involved? Can anything be done to limit the number or ensure some "balance of interests" among participating government departments?
- 4.3 What is required by legislation or regulations in terms of studies? Which studies would you prefer to do? Prefer governments to do?
- 4.4 Are there studies which you should undertake even if they duplicate government studies?
- 4.5 How critical is project timing? Can the review period be shortened if you undertake some or all of the studies?
- 4.6 Who are the "public interest" groups that will involve themselves in this matter?
- 4.7 What corporate policy will be adopted regarding "openness" of project studies?
- 4.8 Is the project "politically sensitive"; that is are there groups who will bear costs without offsetting benefits?
- 4.9 What studies does the corporation have the internal ability to do? What can be done through contracts with research firms?