

Economic Impacts: Predictions versus Outcomes

Common Reasons Why the Predicted Economic Impacts Fall Short

The construction dust has long since settled and the plant has commenced production. As the months pass, however, the economic impacts on the community don't appear as substantial as originally predicted. What happened?

Managing Uncertainty

There will always be uncertainty in any assessment of economic impact, particularly if conducted during the early or prospectus stages of a project. This article discusses the factors most likely to influence the size and accuracy of economic impact assessments including the quality and accuracy of information on the project; methods used to analyze its indirect and induced effects; local procurement success, and market constraints.

Quality of Project Information

The quality of the project's data directly affects the accuracy and representativeness of the economic impact results. Ideally, the economic impacts of a project should be assessed when there is a reasonable degree of certainty regarding the scale, scope and nature of the project. Projects that are vaguely defined or lack information on the sourcing of key inputs (e.g., concrete, wood, labor, etc.) have greater uncertainty and a higher likelihood of being inaccurate than those with detailed spending and procurement profiles vetted by project planners and engineers.

For very large projects, it may be appropriate to revisit the economic impact analysis as the project moves towards implementation and information regarding local procurement of key inputs is refined.

Models, Methodologies, and Assumptions

All economic impact studies need some way to translate the project's direct expenditures into the respective local or regional indirect (and induced) economic impacts. The method used (models or multipliers) and the quality of the data used with each method will affect the accuracy of the estimated economic impacts.

Models versus Multipliers - Using a generalized or generic economic multiplier (e.g., number of direct, indirect, and induced jobs per \$1 million spent) will yield estimates of economic impact that are less accurate than those generated by analyzing a detailed list of project expenditures using a model specific to the economic region or areas. If simple multipliers are used, they need to be specific to the economy and industry directly impacted. It is not appropriate to use multipliers developed for one region or state (e.g., Washington) and apply them to a project in a different region or state (e.g., Nevada).

Input-output models are one of the advanced methods used to analyze economic impacts. They model the flows of goods and services between industries, households, and governments using data collected by government agencies like Statistics Canada or the US Department of Commerce. Used appropriately, they provide the most accurate assessment of a project's impact.

Input-output models vary in their degree of industry and commodity detail (aggregation), which, in turn, affects the amount of information required from project planners. Highly aggregated models can be simulated using relatively few data, making it easier to gather information but reducing confidence in the predicted results. Disaggregated models allow the project data to be analyzed in greater detail and allow tailoring of the input data to reflect the capacity of the economic region to supply key project inputs including goods, services, and labor.

Projects that differ substantially from the economic structures and relationships in the model will produce economic impacts that differ from that predicted. For example, capturing the true economic impacts of a pharmaceutical manufacturing facility using a model based on an economy with no such industry will produce inaccurate findings unless the model is specifically adjusted to reflect new inter-agent relationships that will be created if the project goes ahead.

Because input-output models approximate an economy at a given point in time they will not capture real-time developments that reduce costs or change the mix of inputs used to manufacture a product without deliberate adjustments made to the model. This may be an issue with projects that take several years to complete.

Local Procurement & Supply Constraints

As a general rule, the greater the proportion of goods and services imported from outside the region, the lower the economic impact of the project to the region. If the proportion goods and services sourced locally turns out to be less than assumed by project planners, either during the construction or operation phases of the project, the economic impact of the project will be lower than predicted. It may be that some local businesses did not have the capacity, financing, or managerial skills to take on large contracts or may have been unfamiliar with the project's tendering processes to successfully compete for the project work. Programs that address these barriers without unduly influencing the effectiveness or efficiency of the competitive bid process will improve the likelihood that local firms will benefit and the economic impacts will match expectations.

Input-output models and the multipliers derived from them assume an unlimited or unimpeded supply of all critical inputs required by the project and stable prices for these inputs. Experience has shown, however, that supply constraints can occur and this can reduce realized economic impacts to the region. Regional shortages of skilled construction labor may occur during periods of peak construction. Local suppliers may already be operating at full capacity and unable to expand production within the project's timeframe. In either case, an increased reliance on imported goods and services will reduce the amount of local economic impact compared to that predicted.

Other Market Factors

Sometimes, unforeseen developments in the marketplace can influence whether a project, once operational, meets the expectations set by an economic impact analysis. For example, unexpected swings in exchange rates can significantly impact projects dependent on imports or exports. So too, swings in commodity prices may affect agriculture, mining, and forestry projects. Other reasons include the loss of a key customer account or the failure to wrest market share away from competitors.

Summary Comments

Economic impact assessments, like other tools and processes used to predict or forecast, are fallible. Awareness of the key assumptions, data inputs, and external influences that can affect the analysis and its findings is a fundamental first step. Where budget allows, the sensitivity of any project's economic impact claims should be explored by varying values of the key project assumptions. This process will help identify areas where the project is most vulnerable and where economic development officials can work with project proponents to improve the project's local economic contribution.

Finally, deviations from the predicted economic outcomes are not always negative. Some projects can have a larger impact than first envisioned – through the positive fortunes of markets, the business savvy of the owners, or through proactive procurement policies.

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