Cost performance in large government investment projects that have been subjected to external quality assurance

Concept report no. 51
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English summary

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English Summary

This study examines cost performance in large government investment projects. The issue is whether projects that have been subject to external quality assurance of their cost estimates – a process known as QA2 – have managed to avoid cost overruns. The aim is to ensure that no more than 15% of the projects exceed their budget (commonly set at the estimated P85 value). We also consider whether systematic causes can explain the deviations from the agreed budgets.

A number of studies have demonstrated that cost overrun is a challenge in most countries and industries. The majority of these studies have focused on the transport sector, most of them on road projects. Chapter 2 contains a review of international literature. With two exceptions, all of the studies reviewed showed that the average cost was higher than budgeted. The variation was considerable. About one-third of the studies showed overruns of less than 10%, while one-third showed overruns of more than 50% above budget.

Previous studies have shown that Norwegian projects perform better in this respect than those from other countries. It would thus be tempting to conclude that Norwegian practice is better than elsewhere. However, as discussed in Chapter 3, features such as differences in governance frameworks, time of the formal decision to build, estimation methods, and price conversion practices typically make cross-country comparisons problematic, and could explain the apparent major differences between studies.

The challenge posed by overruns is well documented, but the underlying causes are less well documented. Some of the most common explanations suggested in the literature are discussed in Chapter 4. Some researchers suggest the main reason for overruns is that planners and decision-makers deliberately underestimate costs to present projects in as positive a light as possible. Although there are examples of this practice, not least in the phase before the final investment decision, the support for what is termed ‘strategic misrepresentation’ is limited in academic literature so far.

Instead, the majority of studies have suggested that scope changes, rework and contract omissions are the main causes of overruns. For example, contracts in which the client retained the scope and quantity risk, may have given contractors and suppliers an incentive to provide unrealistically low bids and instead increase their profit margins through change orders.

The past few decades have seen considerable progress in estimation methods in Norway and in other countries. Through applying quantitative uncertainty analysis, we have improved our ability to identify the main uncertainty drivers in projects, and quantify the needed contingencies to account for these uncertainties. Nevertheless, a number of studies have shown that the degree of uncertainty is generally underestimated.

Chapter 5 describes the data and the issues under investigation. We have had access to cost data from 78 projects. Most of these projects have been through QA2 and have been completed, but not all. In some projects, the final accounts have not yet been closed. In a very few projects, the scope has changed significantly, which means that meaningful comparisons with the original budgets cannot be made. Just over half of the projects are road projects, and the remainder are rail, defence, building projects, and ICT projects.
The essential issue in this study is the case projects’ ability to keep within budgets. We look at whether uncertainty has been properly estimated and whether systematic reasons can explain deviations from the budgets. We do not look at project-specific issues that can only be revealed through thorough evaluation of individual projects.

The results are presented in Chapter 6. The key finding is that cost performance in large Norwegian public investment projects is good. On average, the final cost is 7% below the formal budget. Just over 20% of the projects have had final costs over the budget. Still, this is somewhat weaker than expected. If the Norwegian Parliament’s budget is equal to the P85 estimate (which is not always the case), we should expect that a higher proportion of projects would keep within budget. Nevertheless, our findings are considerably better than reported in the international studies referred to in Chapter 2.

Converted to the 2016 value, the total budget of the 78 projects is NOK 124.5 billion. The total for the final costs is NOK 117 billion. In other words, the portfolio of projects turned out to be NOK 7.5 billion (6%) cheaper than budgeted. The results confirm those of previous studies of government projects based on smaller samples. The uncertainty analyses before and during quality assurance (QA2) provide estimates of the standard deviation. A high standard deviation reflects greater uncertainty, which would require a higher contingency. We find that the estimated uncertainty has been too low, especially in road projects. The variation around the P50 in completed projects is higher than what was estimated at the time of the investment decision.

Nevertheless, the risk of large cost overruns seems to be limited. An estimated probability distribution for deviations from the budget shows that the risk of cost overruns above 30% is only 1%. However, the performance of previously completed projects is not a guarantee of how projects will perform in the future. For the state as a self-insurer, and which in principle can diversify between a large number of projects, the results are nevertheless reassuring.

Finally, we look at whether deviations from the P50 estimate can be explained by the size of the standard deviation, year of the investment decision, completion time, number of contracts, time between the investment decision and the start-up, project size, and geography. The spread around the P50 seems to be random, with two exceptions. Projects approved in the years before the financial crisis, i.e. 2004–2008, have had a greater proportion of overruns than projects approved before and after that period. Furthermore, cost performance in urban projects is significantly weaker than in projects carried out elsewhere.

In Chapter 7, we present some conclusions. Although this study does not reveal the clear causal relationships we might have hoped for, the results are reassuring in that they show that the cost estimation and uncertainty analyses include the relevant issues. Hence, when Parliament decides to grant money, it can be reasonably sure that the budget is sufficient.

However, some issues could be improved to enhance future cost estimates. First, estimates of the real uncertainty, especially in urban projects, could be improved. Second, both the governance and management of projects may have potential for improvement; the potential for cost savings may not have been sufficiently explored. Lastly and perhaps most importantly, is the effect of market conditions. Cost fluctuations in the market are usually the dominant systematic uncertainty factor for most construction projects. The projects will typically be shielded from this risk through price adjustments to the budgets with a sector-specific index. However, the actual market prices may vary considerably in relation to this index. Although projects will continue to be exposed to the price fluctuations, the risk is mitigated through the use of price indices.
conditions in national and international markets, unsystematic market uncertainty is more controllable at the level of the agency and the project. Experience from completed projects and studies such as ours needs to be transferred to new ones.

We are currently experiencing a boom in Norwegian government investments. During the next decade, there will be a number of large acquisitions and construction projects. It is therefore reassuring that during the past 15 years of practice we have developed methods and systems that contribute to good cost performance.
<table>
<thead>
<tr>
<th>No.</th>
<th>Report Title</th>
<th>Author(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. 2</td>
<td>Statlig styring av prosjektledelse. Empiri og økonomiske prinsipper. Economic Incentives in Public Project Management</td>
<td>Dag Morten Dalen, Ola Lædre og Christian Riis</td>
</tr>
<tr>
<td>No. 3</td>
<td>Beslutningsunderlag og beslutninger i store statlige investeringsprosjekt Decisions and the Basis for Decisions in Major Public Investment Projects</td>
<td>Stein V. Larsen, Eilif Holte og Sverre Haanæs</td>
</tr>
<tr>
<td>No. 4</td>
<td>Konseptutvikling og evalueriung i store statlige investeringsprosjekt Concept Development and Evaluation in Major Public Investment Projects</td>
<td>Hege Gry Solheim, Erik Dammen, Håvard O. Skaldebø, Eystein Myking, Elisabeth K. Svendsen og Paul Torgersen</td>
</tr>
<tr>
<td>No. 5</td>
<td>Bedre behovsanalyser. Erfaringer og anbefalinger om behovsanalyser i store offentlige investeringsprosjekt Needs Analysis in Major Public Investment Projects. Lessons and Recommendations</td>
<td>Petter Næss</td>
</tr>
<tr>
<td>No. 6</td>
<td>Målformulering i store statlige investeringsprosjekt Alignment of Objectives in Major Public Investment Projects</td>
<td>Ole Jonny Klakegg</td>
</tr>
<tr>
<td>No. 7</td>
<td>Hvordan trur vi at det blir? Effektvurderinger av store offentlige prosjekt Up-front Conjecture of Anticipated Effects of Major Public Investment Projects</td>
<td>Nils Olsson</td>
</tr>
<tr>
<td>No. 8</td>
<td>Reалopsjoner og fleksibilitet i store offentlige investeringsprosjekt Real Options and Flexibility in Major Public Investment Projects</td>
<td>Kjell Arne Brekke</td>
</tr>
<tr>
<td>No. 9</td>
<td>Bedre utforming av store offentlige investeringsprosjekter. Vurdering av behov, mål og effekt i tidligfasen Improved Design of Public Investment Projects. Up-front Appraisal of Needs, Objectives and Effects</td>
<td>Petter Næss med bidrag fra Kjell Arne Brekke, Nils Olsson og Ole Jonny Klakegg</td>
</tr>
<tr>
<td>No. 10</td>
<td>Usikkerhetsanalyse – Kontext og grunnlag Uncertainty Analysis – Context and Foundations</td>
<td>Kjell Austeng, Olav Torp, Jon Terje Midtbø, Ingemund Jordanger, og Ole M Magnussen</td>
</tr>
<tr>
<td>No. 11</td>
<td>Usikkerhetsanalyse – Modellering, estimering og beregning Uncertainty Analysis – Modeling, Estimation and Calculation</td>
<td>Frode Drevland, Kjell Austeng og Olav Torp</td>
</tr>
<tr>
<td>No. 12</td>
<td>Metoder for usikkerhetsanalyse Uncertainty Analysis – Methodology</td>
<td>Kjell Austeng, Jon Terje Midtbø, Vidar Helland, Olav Torp og Ingemund Jordanger</td>
</tr>
</tbody>
</table>
Usikkerhetsanalyse – Feilkilder i metode og beregning
Uncertainty Analysis – Methodological Errors in Data and Analysis
Kjell Austeng, Vibeke Binz og Frode Drevland

No. 14
Positiv usikkerhet og økt verdiskaping
Positive Uncertainty and Increasing Return on Investments
Ingemund Jordanger

No. 15
Kostnadsusikkerhet i store statlige investeringsprosjekter; Empiriske studier basert på KS2
Cost Uncertainty in Large Public Investment Projects. Empirical Studies
Olav Torp (red.), Ole M Magnussen, Nils Olsson og Ole Jonny Klakegg

No. 16
Kontrahering i prosjektets tidligphase. Forsvarets anskaffelser.
procurement in a project’s early phases. Defense acquisitions
Erik N. Warberg

No. 17
Beslutninger på svakt informasjonsgrunnlag.
Tilnærminger og utfordringer i prosjektets tidlig fase
Decisions Based on Scant Information. Challenges and Tools During the Front-end Phases of Projects
Kjell Sunnevåg (red.)

No. 18
Flermålsanalyser i store statlige investeringsprosjekter
Multi-Criteria Decision Analysis in Major Public Investment Projects
Ingemund Jordanger, Stein Malerud, Harald Minken, Arvid Strand

No. 19
Effektvurdering av store statlige investeringsprosjekter
Impact Assessment of Major Public Investment Projects
Bjørn Andersen, Svein Bråthen, Tom Fagerhaug, Ola Nafstad, Petter Næss og Nils Olsson

No. 20
Investorers vurdering av prosjektets godhet
Investors’ Appraisal of Project Feasibility
Nils Olsson, Stein Frydenberg, Erik W. Jakobsen, Svein Arne Jessen, Roger Sørheim og Lillian Waagø

No. 21
Logisk minimalisme, rasjonalitet - og de avgjørende valg
Major Projects: Logical Minimalism, Rationality and Grand Choices
Knut Samset, Arvid Strand og Vincent F. Hendricks

No. 22
Miljøøkonomi og samfunnssøkonomisk lønnsomhet
Environmental Economics and Economic Viability
Kåre P. Hagen

No. 23
The Norwegian Front-End Governance Regime of Major Public Projects – A Theoretically Based Analysis and Evaluation
Tom Christensen

No. 24
Markedsorienterte styringsmetoder i miljøpolitikken
Market oriented approaches to environmental policy
Kåre P. Hagen

No. 25
Regime for planlegging og beslutning i sykehusprosjekter
Planning and Decision Making in Hospital Projects. Lessons with the Norwegian Governance Scheme.
Asmund Myrbostad, Tarald Rohde, Pål Martinussen og Marte Lauvsnes

No. 26
Politisk styring, lokal rasjonalitet og komplekse koalisjoner. Tidligfaseprosessen i store offentlige
Concept report no. 51
Erik Whist, Tom Christensen
<table>
<thead>
<tr>
<th>No.</th>
<th>Title</th>
<th>Author(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>27</td>
<td>Verdensetting av fremtiden. Tidshorisont og diskonteringsrenter</td>
<td>Kåre P. Hagen</td>
</tr>
<tr>
<td>28</td>
<td>Fjorden, byen og operaen. En evaluering av Bjørvika byggingen i et beslutningsteoretisk perspektiv</td>
<td>Erik Whist, Tom Christensen</td>
</tr>
<tr>
<td>29</td>
<td>Levedyktighet og investeringstiltak. Erfaringer fra kvalitetssikring av statlige investeringsprosjekter</td>
<td>Ola Lædre, Gro Holst Volden, Tore Haavaldsen</td>
</tr>
<tr>
<td>30</td>
<td>Etterevaluering av statlige investeringsprosjekter. Konklusjoner, erfaringer og råd basert på pilotevaluering av fire prosjekter</td>
<td>Gro Holst Volden og Knut Samset</td>
</tr>
<tr>
<td>31</td>
<td>Store statlige investerings befydning for konkurranse- og markedsutviklingen. Håndtering av konkurransemessige problemstillinger i utredningsfasen</td>
<td>Asbjørn Englund, Harald Bergh, Aleksander Møll og Ove Skaug Halsos</td>
</tr>
<tr>
<td>32</td>
<td>Analyse av systematisk usikkerhet i norsk økonomi.</td>
<td>Haakon Vennemo, Michael Hoel og Henning Wahlquist</td>
</tr>
<tr>
<td>33</td>
<td>Planprosesser, beregningsverktøy og bruk av nytte-kostnadsanalyser i vegsektoren. En sammenlikning av praksis i Norge og Sverige.</td>
<td>Morten Welde, Jonas Eliasson, James Odeck, Maria Börjesson</td>
</tr>
<tr>
<td>34</td>
<td>Mulighetsrommet. En studie om konseptutredninger og konseptvalg.</td>
<td>Knut Samset, Bjørn Andersen og Kjell Austeng</td>
</tr>
<tr>
<td>35</td>
<td>Statens prosjektmøll. Bedre kostnadsstyring. Erfaringer med de første investeringstiltakene som har vært gjennom ekstern kvalitetssikring</td>
<td>Knut Samset og Gro Holst Volden</td>
</tr>
<tr>
<td>36</td>
<td>Investing for Impact. Lessons with the Norwegian State Project Model and the First Investment Projects that Have Been Subjected to External Quality Assurance</td>
<td>Knut Samset og Gro Holst Volden</td>
</tr>
<tr>
<td>37</td>
<td>Bruk av karbonpriser i praktiske samfunnsøkonomiske analyser. En oversikt over praksis fra analyser av statlige investeringsprosjekter under KVU-KS1-ordningen.</td>
<td>Gro Holst Volden</td>
</tr>
<tr>
<td>Report No.</td>
<td>Report Title</td>
<td>Authors</td>
</tr>
<tr>
<td>-----------</td>
<td>-------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------</td>
</tr>
<tr>
<td>No. 39</td>
<td>Non-Monetized Impacts in Economic Analysis. Practice and Lessons from Public Investment Projects</td>
<td>Morten Welde, Knut Samset, Bjørn Andersen, and Kjell Austeng</td>
</tr>
<tr>
<td>No. 40</td>
<td>Low estimates – high stakes. A study of underestimation of costs in projects' earliest phase</td>
<td>Knut Samset, Gro Holst Volden, Morten Welde, and Heidi Bull-Berg</td>
</tr>
<tr>
<td>No. 41</td>
<td>Transport models and extreme scenarios. A test of the NTM5 model.</td>
<td>Christian Steinsland and Lasse Fridstrøm</td>
</tr>
<tr>
<td>No. 42</td>
<td>User fees in the road sector</td>
<td>Kåre Petter Hagen and Karl Rolf Pedersen</td>
</tr>
<tr>
<td>No. 43</td>
<td>Road Planning in Norway: What governs the selection of projects?</td>
<td>Arvid Strand, Silvia Olsen, Merethe Dotterud Leiren, and Askil Harkjør Halse</td>
</tr>
<tr>
<td>No. 44</td>
<td>Resource allocation in the transport sector – some potential improvements</td>
<td>James Odeck (red.) and Morten Welde (red.)</td>
</tr>
<tr>
<td>No. 45</td>
<td>Municipal investment practices in Norway.</td>
<td>Morten Welde, Jostein Aksdal, and Inger Lise Tyholt Grindvoll</td>
</tr>
<tr>
<td>No. 46</td>
<td>Governance schemes for major public investment projects: A comparative study of principles and practices in six countries</td>
<td>Knut F. Samset, Gro Holst Volden, Nils Olsson, and Eirik Vårdal Kvalheim</td>
</tr>
<tr>
<td>No. 48</td>
<td>Environmental Impact of Large Investment Projects. An Anthology by 16 Norwegian Experts.</td>
<td>Kåre P. Hagen and Gro Holst Volden</td>
</tr>
<tr>
<td>No. 49</td>
<td>Finansiering av vegprosjekter med bompenger. Behandling av og konsekvenser av bompenger i samfunnsøkonomiske analyser.</td>
<td>Morten Welde, Svein Bråthen, Jens Rekdal, and Wei Zhang</td>
</tr>
</tbody>
</table>

Concept report no. 51
### Concept report series

<table>
<thead>
<tr>
<th>Report</th>
<th>Title</th>
<th>Author(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. 50</td>
<td>Financing road projects with tolls. The treatment of and consequences of tolls in cost benefit analyses.</td>
<td>Bjørn Andersen, Eirik Vårdal, Kvalheim og Gro Holst Volden</td>
</tr>
<tr>
<td>No. 51</td>
<td>Kostnadskontroll i store statlige investeringer underlagt ordningen med ekstern kvalitetssikring.</td>
<td>Morten Welde</td>
</tr>
</tbody>
</table>

**Report Title**: No. 51

**Author**: Morten Welde

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**English Summary**

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Forskningsprogrammet Concept skal utvikle kunnskap som sikrer bedre ressursutnytting og effekt av store, statlige investeringer. Programmet driver følgeforskning knyttet til de største statlige investeringsprosjektene over en rekke år. En skal trekke erfaringer fra disse som kan bedre utformingen og kvalitetssikringen av nye investeringsprosjekter før de settes i gang.

Concept er lokalisert ved Norges teknisk-naturvitenskapelige universitet i Trondheim (NTNU), ved Fakultet for ingeniørvitenskap og teknologi. Programmet samarbeider med ledende norske og internasjonale fagmiljøer og universiteter, og er finansiert av Finansdepartementet.

The Concept research program aims to develop know-how to help make more efficient use of resources and improve the effect of major public investments. The Program is designed to follow up on the largest public projects over a period of several years, and help improve design and quality assurance of future public projects before they are formally approved.

The program is based at The Norwegian University of Science and Technology (NTNU), Faculty of Engineering Science and Technology. It cooperates with key Norwegian and international professional institutions and universities, and is financed by the Norwegian Ministry of Finance.