

Public-private partnerships – Expensive and foolish

Report by Hallvard Bakke



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Foreword

We are now seeing more and more tasks that were previously handled by the public sector being taken over by private-sector operators. The argument advanced when private players take on public tasks is that this is “economically necessary”, without any alternatives being considered. Because the public sector is the backbone of the welfare state, Fagforbundet is anxious that welfare schemes should be owned, financed and operated by the State and should be subject to political management and democratic control. In this connection, we are now drawing up reports to show what this means. The report entitled “Public-private partnerships – expensive and foolish” [“Offentlig-privat samarbeid – dyrt og dumt”] is part of this effort.

The objective of the work being undertaken by Fagforbundet is to convey more understanding of what it means when private operators take over public tasks, and to suggest alternative solutions. The questions to be addressed include: Are private-sector solutions cheaper for society? Is there any effect on the quality of services? What happens to the pay and working conditions of the staff when private companies take over? Is there any effect on public transparency when private companies take over public services – and what happens to checks on the use of public funds?

The report “Public-private partnerships – expensive and stupid” has been produced by Hallvard Bakke on behalf of Fagforbundet. Public-private partnerships (PPPs) are a method of financing public investments, mainly used in countries that are in a difficult economic situation. The State can borrow money from private investors to finance, establish or run services, or any combination of these three. The report takes a broad view of PPPs. Among other things, it shows the extent to which PPPs are used in Europe, and takes a detailed look at experience with PPPs in the UK and Norway. The report also analyses some of the evaluation reports on PPP projects. It then discusses some PPP projects carried out in the City of Oslo.

Jan Davidsen

President of Fagforbundet Oslo, February 2011

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1. Summary and conclusions

In recommendation 2 S (2010-2011) on the national budget and the proposed state budget for 2011, the Conservative members of the Finance Committee write that:

“The experience from the initial projects involving public-private partnerships (PPPs) has been so good, with half the construction time and improved cost control, that these members consider that the model should be applied to road and rail improvement projects on suitable sections. These members would like to see funds earmarked to implement 3–5 PPP projects each year. For 2011, these members therefore propose that NOK 200 million should be approved for the planning of PPP projects.”

At the end of the year, Bjørn Rune Gjelsten and the Fabritius Group offered to build a new hospital in Molde (at a cost of NOK 3,000 million) as a PPP project. This was strongly supported by both the Conservatives and the Progress Party. There is thus no doubt that if the 2013 elections give these two parties a parliamentary mandate to form a ‘blue-blue’ government, there will be extensive use of PPPs in public investments in roads, healthcare and other state-run building projects.

PPPs in Oslo In Oslo, the Conservative-Progress Party City Council tabled a proposition on 7 September 2010 on “The use of public-private partnerships (PPPs)”, presenting “a description of how the City intends to make use of PPPs in the building and construction field in the future.” The City Council points out that the City of Oslo is expected to see an annual population growth of some 10 000 inhabitants up to 2030, and that the City therefore urgently needs to make large investments in schools, hospitals, nurseries and general social infrastructure in the coming years. The City Council writes that the experience gained, both at the national level and in the City of Oslo, shows that public-private partnerships (PPPs), based on PPP contracts, can help to improve capacity, promote the sensible and efficient use of public funds, and contribute to more innovation, higher quality and a greater focus on whole-life costs. In Oslo too, and doubtless in other municipalities, continued Conservative-Progress Party cooperation will result in much greater use of PPP contracts.

Any PPP agreement will have higher financing costs than traditional types of contract. This is because the State can obtain lower interest rates, as the

risk is seen as greater for private borrowers, who will normally need a certain amount of equity capital in order to get a loan. The required return on this equity will be higher than bank interest. And finally, a private contractor will have to maintain capital for a period of 25 years into the future (the normal term for PPP contracts). There is a premium to be paid for this. The normal added cost of financing will therefore approach two per cent per year for every year of the contract term (in December 2008, PricewaterhouseCoopers estimated that “interest rates on loans for infrastructure projects are around 1.5 to 2 per cent above the lowest rate that governments can obtain”). It is often claimed (by the City of Oslo, for example) that the added costs are around one per cent, but this does not take account of the equity funding costs or the premium for whole-life financing. And even with financing costs just one per cent higher, the added costs over the contract period will be significant.

Nor is there any dispute that PPP contracts will have higher transaction costs than normal contracts, both for the contractor and for the public authority that signs the contract. Experience shows that the transaction costs may be estimated at 1.5–3 per cent of the value of the contract with a PPP, against 0.5–1 per cent with traditional agreements. Then there are the public authority’s own transaction costs. PPPs also entail higher costs for the companies that enter bids without getting the contract.

One advantage put forward for PPP contracts is that the risk is transferred from the State to the private contract partner. However, this transfer of risk has to be paid for. The International Monetary Fund (IMF) has warned governments against exaggerating the real value of this transfer of risk: “It is also possible that the government overprices risk and overcompensates the private sector for taking it on, which would raise the cost of PPPs relative to direct public investment.”

The State also runs the risk of the contract partner going bankrupt or being unable to complete the contract for other reasons. This can result in large extra costs, as we saw with London Underground when Metronet collapsed.

As a PPP contract involves both financing and maintenance over a 25-year period, in addition to the actual construction, this could prevent individual contractors from participating in the competitive bidding process. This would then reduce competition, in turn increasing costs. Over such a long term as 25 years, there will often be a need for changes in the course of the contract period. In the event of such changes, the PPP contractor will be in a monopoly situation, which will increase the costs compared to putting the changes and additional work out to tender in a normal competitive

situation, as can be done when the building is put up independently. If PPPs are to be more efficient than traditional contracts, the construction costs, operation and maintenance must be so much cheaper that they more than offset the increased costs that PPPs bring. Experience from Norway and abroad, where such contracts have been used for almost twenty years, shows that this is not the case. On the contrary, PPP projects are almost always more expensive. Where PPP contracts have been used anyway, especially in the UK, this has mainly been from a desire to limit the amount of public debt shown in the accounts.

Experience in Norway

In 2001, the Norwegian parliament decided to run three road building projects as PPPs: these were the E 39 Bårdshaug–Klett, Lyngdal–Flekkefjord and Kristiansand–Grimstad. The projects were based on the PPP company in each of them taking responsibility for 1) building a specified stretch of road on a ‘total enterprise’ basis, 2) financing the construction in return for the State paying the company for its investment over a 25-year period, 3) operating and maintaining the roads over a 25-year period in return for a payment agreed beforehand.

The Ministry of Transport and Communications commissioned the Institute of Transport Economics (TØI), in collaboration with Dovre International, to evaluate the three projects. This evaluation was published in TØI report 890/2007. At that time, only two of the projects were completed, while the third, Kristiansand–Grimstad, was completed in 2009.

In its report, the TØI writes that PPPs result in “a more efficient use of resources”. However, this conclusion is based on the fact that the actual construction period for the first two projects was shorter than for other projects carried out in the traditional way. This in turn is due to the fact that the PPP projects were fully financed from the outset, where other projects were part-financed. The shorter construction time is therefore not due to the PPP approach as such, but to the way the financing is handled. The same construction time can be achieved by building in the traditional way if the project is fully financed. This is also stated in the report, which points out that with project financing via the State budget, the whole project can be planned and implemented without being tied to the annual budget processes. “At the organisational level, this model can have the same advantages in terms of overall conception and predictability as an ordinary PPP project. We therefore assume that shorter construction times can be achieved here also.”

The report says that “no basis has been found for claiming that the pilot

projects have brought substantial savings in construction costs". In reality, the construction costs for the first two projects mentioned above were higher when compared to previous reported figures and with traditional methods. The Norwegian Public Roads Administration did not carry out an evaluation of the largest project, Kristiansand–Grimstad, but other information indicates that the PPP contractors here suffered substantial losses.

The TØI report also says that the theory that PPPs produce extensive technical innovation "is scarcely borne out by reality". The theory that placing overall responsibility in the hands of a private company will mean that more is invested in the construction phase in order to reduce operating and maintenance costs "is not proven". The report also states that "PPPs may cause projects to be more expensive for the public purse than they would otherwise have been". This is because the PPP companies bear the building costs risk, and for this, the State has to pay a certain risk premium.

A halting comparison

Several schools have been built in Oslo under PPP contracts. The City engaged Reinertsen AS to compare Persbråten (PPP) and Bjørnholt (built under a normal contract), and SINTEF to evaluate Persbråten and Høybråten (both PPPs). Reinertsen AS found that the actual investment costs (excluding financing) were roughly the same for the two schools after taking account of functional differences (NOK 20,599/m² for Persbråten, NOK 20,664/m² for Bjørnholt). In its report, the company maintains that the financing costs for the two schools should then be similar. However, the financing costs of a PPP project are significantly higher than with a traditional contract.

SINTEF found that the construction costs for Persbråten under a PPP were NOK 58 million lower than they would have been with a traditional implementation. However, this was because they added a wholly unrealistic risk premium of 30 per cent to the original figure. The actual construction costs for Persbråten were roughly the same as for schools built by the traditional method.

The City's own company Undervisningsbygg writes in a letter dated 12 October 2010 that it is difficult to draw any reliable conclusions based on the limited number of PPP projects that Undervisningsbygg has carried out. It refers to the report from Reinertsen AS. "Even if the conclusion reached in that report may be considered slightly unreliable, the result of the comparison is that there are no significant differences in investment costs. On average, the administrative, operating and maintenance costs are

somewhat higher in PPP projects. There is no benchmark for the Høybråten school PPP project, but there are grounds for supposing that a comparison would produce the same result for this project too.”

In its proposition 217/2010, Oslo City Council suggests three main elements that should make PPPs profitable to the municipality:

- greater capacity for implementation
- increased competition
- more added-value in the form of new solutions

Undervisningsbygg writes in its letter of 12 October 2010 that when it is decided what should be built, they have no problem driving their projects forward. Consequently, there is nothing to suggest that their capacity would be any better with a PPP. Nothing in the experience gained to date indicates that PPPs yield new solutions that provide “more added-value”. There is rather less competition with PPP projects than with normal contracts, because many contractors cannot afford a commitment that involves financing and 25 years’ operation and maintenance on top of the actual construction. In negotiations on subsequent changes, the PPP contractor will be in a monopoly situation, which will entail higher costs than if the work could be put out to normal competitive bidding.

Experience from Norway and abroad shows that PPP projects are more expensive than if they had been implemented in the normal way under public-sector control. This is also the reason why the Conservative-Liberal Cameron government in the UK has cancelled all new PPP projects, because experience has shown that they are a waste of public funds..

2. What are PPPs?

PPP stands for public-private partnership. In the UK, the term PFI (Private Finance Initiative) is also used where private investors finance public building projects, which is the usual form of PPP. However, there will always be extensive partnership between the private and public sectors, and if the initials are meant to cover any such cooperation, they will be pretty meaningless.

It has always been common practice for public bodies to engage private companies to handle the actual construction of things like schools, hospitals, prisons, roads and other major infrastructure facilities by way of tendering processes. However, the PPP approach goes much further than a normal tender, as it also includes financing, operation and maintenance, and the ownership of buildings and facilities within an overall project. The costs incurred by the private operators will still be borne by the State, either by direct payment from public budgets or by the private owners taking over public sources of income for the projects. The financing may also be a combination of these.

(Bjarne Jensen, 2010, unpublished note).

The consultants KPMG have provided the following definition: “A public service developed and/or operated by private companies (or together with public bodies), where the risk is shared between the private and public sectors.” (Analysis and report on forms of public-private partnership (PPP), 2003). In the KPMG report, a public service is taken to include both traditional service provision and infrastructure.

The Norwegian PPP portal (<http://www.ops-portalen.net/>) states, under the heading “What is a PPP”, that a public-private partnership involves cooperation between the public and private sectors on a project or service, where the private sector assumes a major part of the liability associated with the development and/or operation of the project/service. The publicsector player specifies the task to be performed, the standards to be followed and the quality to be delivered. Within these parameters, the private operator is free to plan and execute the work in the most appropriate way. “The appropriate use of PPPs can help to foster innovation and improve the quality of public projects and services, while also contributing to more efficient use of public resources. PPP projects can also

be a source of knowledge development and sharing of skills between the public and private sectors, which can help to improve public services.”

The NHO on PPPs

The Confederation of Norwegian Enterprise [Næringslivets Hovedorganisasjon – NHO] writes that “Public-private partnerships involve cooperation between the public and private sectors on a project or service. They arise from the need to address a task for the inhabitants of a municipality or county (fylke). This may be anything from a road or a school to an old people’s home, town hall or sports facility to be built, operated and maintained.

The public-sector developer specifies the task to be carried out and defines the standards to be followed and the quality to be delivered. Within these parameters, the private operator is free to plan and execute the work in the most appropriate way.

In the PPP model, the private-sector partner also bears the responsibility for financing the project. This does not mean that the State does not have to pay. The private operator organises the financing of the building work, and is reimbursed by way of fixed repayments from the developer or by charges to users, such as leasing payments or tolls. Normally, the State takes over the project free of charge after an agreed time or when it has been paid off.” (What are PPPs? 25 February 2004).

The NHO mentions that there may also be projects where the State does not take over after a contract period of 25 years, for example, or where the State has the option to take over but is not obliged to do so. In such cases, the annual repayment to the PPP contractor from the State is of course lower than if it also intended to take ownership of the project at the end of the contract.

The NHO writes that PPPs are a flexible model, in which the financing and organisation can be adapted to a given project and the requirements that exist. The model can also help projects to be launched and implemented more quickly. “A PPP project places greater demands on the client. At the same time, it is important for both parties to be prepared to enter into a real partnership based on trust and openness, to create a sound foundation for success. The sharing of risk is crucial in this context. In a PPP model, the risk is shared between the public and private sectors according to which party is best equipped to assess the risk.”

The advantage of PPP projects, writes the NHO, compared to more

traditional contracts, is that the private partner is given more end-to-end responsibility for planning and executing the projects. It is in this overall responsibility that the savings in the PPP model are to be made.

According to the NHO, the PPP model can yield savings of up to 20 per cent, although the figure is generally around 10 per cent. Still, these are large sums when seen in the light of the large investments made by the State every year. The savings to the public purse can then create budgetary resources for other purposes, or improve the quality of the projects to be carried out, the NHO report says.

Attention has been given to the extent to which PPP projects can tie up future state and municipal budgets. An analysis of the macro-economic impact of the PPP model conducted by KPMG ("Analysis and report on forms of public-private partnership (PPP), a KPMG report to the Ministry of Trade and Industry, 2003) shows that PPPs, as an addition to other traditional contracts, do not tie up future state or municipal budgets. The main grounds for this conclusion are that a large proportion of the public budgets is tied to commitments like social services, schools, defence, etc. In percentage terms, investment accounts for a small part of the total budgets, and so makes up a limited part of the total Norwegian economy. Individual industries, such as building and construction, may however be affected by increased investment activity.

"The efficiency gains in the PPP model are still significant because we are talking about large amounts in terms of NOK. Altogether, some NOK 37 billion are invested each year. An increase of just five per cent in the efficiency with which these resources are used would release over NOK 1.5 billion.

In many ways, public-sector investments under the PPP model can be compared with loan financing of projects. A loan also has to be repaid in the future. The cash flow within a PPP model will however depend on the form of financing the public body opts for. KPMG's analysis also shows that national accounting models and the monitoring of municipal budgets will pick up PPP projects in a similar way to other projects. In this way, the State retains control over activities and future commitments within the budgets."

In this report, we will examine, among other things, whether the experience gained to date bears out the advantages claimed by the NHO, and whether PPPs "generally" produce savings of "around 10 per cent", while findings from "other countries show that the PPP model can produce savings of up to 20 per cent."

The NHO also describes PPPs as an “addition to other traditional contracts”, but still estimates the ostensible savings from PPPs, on the assumption that the model is used for all public investments, at some NOK 37 billion in total (2004). Even in the UK, which is the country with by far the greatest use of PPPs (PFI), PPP projects only account for 10–12 per cent of all public investments.

The Norwegian PPP portal refers to the World Bank, which writes that: “Any PPP solution is too complex and too specific to be described in a single word or a single acronym.” (Source: see bibliography)

In this report, all PPP projects contain the following elements:

1. An investment in public facilities and infrastructure based on a ‘total enterprise’ approach.
2. Binding agreements on the operation and maintenance of these public facilities and infrastructure over a long period, against a price agreed beforehand. The period generally ranges from 20 to 40 years.
3. Financing of the investment whereby the State pays annual interest charges and installments based on pre-agreed interest rates and a repayment plan extending over the same period as the operational and maintenance agreement.

(Bjarne Jensen, unpublished note, 2010).

3. Background to the growth of PPPs

The rapid growth in PPP contracts in the EU from 1996 onwards had a lot to do with the Maastricht Treaty and the associated Growth and Stability Pact. The aim of this was to limit budget deficits in the Member States. The criteria for joining the monetary union were that the annual deficit should not exceed three per cent of GDP and that gross government debt should not exceed 60 per cent of GDP.

However, there are different ways of defining government debt. Under EU rules, public companies that operate commercially and charge for their services, such as nationalised railway companies, do not count. Both the UK and the International Monetary Fund include any borrowing by such companies in government debt. This means that, under EU rules, there is no direct incentive to use PPPs for investments in railways, for example, as loans for such investments will not be included in government debt anyway. On the other hand, the reported government deficit will be reduced if investments in hospitals and educational institutions, for example, are made via PPPs.

In 2004, the statistical office of the EU, Eurostat, ruled that fixed capital involved in PPP projects should be classified as non-government capital, and hence excluded from the national balance-sheet, provided that a) the private partner bears the development risk, and b) the private partner bears either the availability or the demand risk. The availability risk only covers the risk of the project ceasing to operate, while the risk of it becoming obsolete or unusable in the 25–30 year period of the contract is borne by the State. This made it easy to remove debt from the state balance-sheet without transferring any great risk to the private sector participants.

However, the International Monetary Fund (IMF) did not agree with this definition and stated that the “recent Eurostat decision on accounting for risk transfer gives considerable cause for concern, because it is likely to result in most PPPs being classified as private investment ... since most PPPs involve the private sector bearing construction and availability risk, they will probably be treated as private investment, even though the government bears substantial risk (e.g., when it guarantees to the private operator a minimum level of demand for the service provided through the PPP), ... the recent decision ... thus could provide an incentive for EU

governments to resort to PPPs mainly to circumvent the Stability and Growth Pact (SGP) fiscal constraints” (International Monetary Fund, Public Investment and Fiscal Policy, 12 March 2004).

There has therefore been great uncertainty as to how PPP projects should be accounted for. The tendency now is for them to be recorded as government debt, so there is no longer the option of creative accounting to reduce the official debt figure.

4. PPPs in the EU

The European Commission has been striving for some time to encourage Member States to make more use of PPPs. In 2004, it published a Green Paper on PPPs intended “to facilitate the development of PPPs under conditions of effective competition and legal clarity.” The EU has established its own European PPP Expertise Centre (EPEC), where the EU and the European Investment Bank can “disseminate information and best practise for the benefit of Europe’s public PPP task forces and provide policy and programme support in PPP procurement and management to its public sector membership.”

There are various ways of defining PPPs, and the statistics are not all equally reliable. This will in turn affect any summary of the scale of PPP contracts. Here, we have used the statistics from the European Investment Bank (EIB) from July 2010 (Economic and Financial Report 2010/04). These do not include contracts with a capital value below € 5 million (approx. NOK 40 million).

4.1. Geographical distribution

In the period from 1990 to 2009, over 1300 PPP contracts were signed in EU countries with a total capital value in excess of € 250 billion, or around NOK 2,000 billion. The value increased progressively each year until 1998, when contracts with a total value of some € 20 billion (NOK 160 billion) were concluded. In the next few years, the value of PPP contracts went down slightly, only to reach new peaks in 2005–2007. In 2007, 136 new contracts were signed, with a total value of almost € 30 billion (NOK 240 billion). Then the financial crisis took hold, and in 2008, the volume was almost halved, with 118 contracts worth around € 16 billion (NOK 130 billion).

The financial crisis also caused the average size of PPP contracts to decrease. Whereas the average PPP contract was worth € 217 million (OBS!) (NOK 1,700 million) in 2007, the figure went down by more than half in 2009, to € 91 million (around NOK 730 million). This brought it down to the same level as in the period 2001–2006.

In the period 1990–2009, the UK accounted for some two-thirds of all European PPP projects, and over half of the total capital value. Spain was next, with 10 per cent of the projects, followed by France (5.1 per cent), Germany (4.9 per cent) and Portugal (3.1 per cent). If we look at

our neighbouring countries, Denmark, Sweden and Finland each account for 0.1 per cent of the projects.

If we consider the capital value, the UK has 52.5 per cent, Spain 11.4 per cent, Portugal 7.0 per cent and Germany 4.1 per cent. Finland and Sweden each have 0.2 per cent of the value, while Denmark does not even reach 0.1 per cent. Of the new EU countries, Hungary leads the way with 0.7 per cent of the number of contracts and 2.3 per cent of the value.

Although, according to the EIB, Italy only accounts for 2.3 per cent of the total number of contracts and 3.3 per cent of the value over the whole period 1990–2009, by 2007 it had become by far the largest PPP country beside the UK.

4.2. Sectors

In terms of the breakdown of PPP contracts by sector, there is a substantial difference between the UK and other countries. In the UK, education takes the largest share, at 27 per cent, with healthcare close behind on 25 per cent. This is attributable to large-scale projects to build new schools and hospitals. Despite the major Underground project in London, transport makes up just 17 per cent of the total. Defence projects also accounted for a significant proportion, especially in more recent years.

In the rest of the EU, it is transport contracts that predominate, with over 80 per cent of the value, the lion's share going to build new roads. After 2000, roads account for 80 per cent of the value of PPP contracts. The proportion of contracts in healthcare and education has increased in recent years, but still plays a lesser role in the rest of the EU than in the UK.

4.3. Economic importance

If we examine the economic importance of PPP contracts, we find that these investments make up less than one per cent of the total gross domestic product (GDP) in the EU. They also account for a small part of total public investments. The majority of public investments are still organised in the traditional way, with the State or local authorities borrowing the money. A separate construction contract is entered into, and maintenance and service provision are handled by their own employees or outsourced under specific contracts. A global study by Siemens found that only about five per cent of all public-sector investments took the form of PPP contracts. “Loan financing is therefore expected to remain the major

financial instrument in Europe”, according to this report (Siemens, Public infrastructures and private funding, 2007).

Even in the UK, which has by far the largest share of PPP contracts, these have only made up 10–15 per cent of public-sector investment since 1996. The remainder has involved traditional borrowing and contracts.

After the UK, the PPP portion of public investments is largest in Portugal, Spain and Ireland. Interestingly enough, these are among the countries that have had the greatest problems since the financial crisis.

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In the UK, PPPs account for around 10 per cent of investments in the transport sector, against less than five per cent in the rest of the EU in the period 2005–2008, and even less in the preceding years. In the case of education, the proportion in the UK increased from one per cent in the 1990s to 20 per cent in the period 2005–2009. In the rest of the EU, the figure is insignificant. PPPs make up the largest proportion of investments in the UK in the healthcare sector, representing around 40 per cent of investments in the years 2005–2007, while the proportion in the rest of the EU is around one per cent.

For a number of companies, PPPs have opened up a large and profitable new market. A global overview by Standard & Poor's of the 75 largest companies in the world that invest in infrastructure, which makes up the bulk of PPP contracts, shows that the share prices of these companies rose by more than 250 per cent in the period 2002–2007, while the global average for all large corporations was under 100 per cent over the same period. (PSIRU, 2008)

5. PPPs in individual countries

5.1. United Kingdom

5.1.1 *London Underground*

In 2003, contracts were signed with two companies to modernise the London Underground ahead of the Olympic Games in 2012. These contracts totalled £15.7 billion (NOK 150 billion), repayable over 30 years. This is the largest PPP contract ever concluded in the UK, accounting for 1/6 of the total value of such contracts. In 2007, one of the two contract partners, Metronet BCV and Metronet SSL, went bankrupt, forcing London Underground Ltd to meet 95 per cent of the company's debts, which cost the State £1.7 billion (approx. NOK 17 billion).

In May 2010, it was decided that the other partner, Tube Lines, should also be bought out, bringing the London Underground back into full public ownership. This purchase cost £310 million. "A colossal waste of money", said London's Conservative Mayor Boris Johnson of this PPP arrangement when it was all over (The Independent, 10 May 2010).

In connection with the collapse of Metronet, the UK's National Audit Office produced a report entitled "The failure of Metronet". There was also a separate parliamentary report (House of Commons Transport Committee: The London Underground and the Public-Private Partnership Agreements; Second Report of Session 2007-08 HC 45, 16 January 2008). This report is a scathing criticism of the contracts.

The agreements with Metronet were "out of all proportion to the level of risk associated with the contract". The two Metronet companies had managed to limit their liability to £70 million each. It was not then the case that the private sector had taken a large part of the risk away from the State; quite the opposite. If the company had been properly managed, its shareholders would have made a formidable profit. When it collapsed, most of the bill was picked up by taxpayers and passengers.

The report warned the government against signing any similar contracts in the future. It pointed out that the private sector will never take a substantial risk without being amply rewarded. It is ultimately the taxpayers who have to pay for this. "Whether or not the Metronet failure was primarily the fault of the particular companies involved, we are inclined to the view that the model itself was flawed and probably inferior to traditional public-sector management. We can be more confident in this

conclusion now that the potential for inefficiency and failure in the private sector has been so clearly demonstrated. In comparison, whatever the potential inefficiencies of the public sector, proper public scrutiny and the opportunity of meaningful control is likely to provide superior value for money. Crucially, it also offers protection from catastrophic failure. It is worth remembering that when private companies fail to deliver on large public projects they can walk away – the taxpayer is inevitably forced to pick up the pieces.”

5.1.2. Hospitals

Another area for PPPs has been the construction of new hospitals. In August 2010, the BBC reported that, for the 103 hospitals built under the PPP model (called the PFI in the UK), where private investors finance the building and the State pays back over a period of 25–45 years, the original construction costs ran to £11.3 billion (approx. NOK 110 billion). When the last contract runs out in 2048, the National Health Service (NHS) will have paid out £65.1 billion (approx. NOK 650 billion), or six times as much, if we include the costs of maintenance, cleaning and catering (BBC, 13 August 2010).

The UK Department of Health, which sponsored this project, claims that it got “value for money”. Few others would agree with this. One calculation suggests that the running costs of PPP-financed hospitals are 12 per cent higher than for public hospitals. In August 2010, the Financial Times wrote that private contractors look for an annual return of 8–10 per cent. In some cases, the revenue is much more.

Professor Jean Shaoul of Manchester University has calculated that, for the first 12 PPP hospitals, the dividend paid to private shareholders averaged 58 per cent. According to The Economist, some of the consultants who advised on the PPP contracts says that it is “quite perverse” to channel public money into private financing initiatives in this way (The Economist, 18 March 2010).

Alan Maynard, who is Professor of Health Economics at the University of York, says: “If you are trying to raise money for a new hospital, the best rates come from government borrowing. Why use private capital when it is always more expensive?” The only justification, he says, for using private finance is if it comes with better management. “But there is simply no evidence of that. There is no data. There have been no studies.” (The Daily Telegraph, 10 March 2010).

Doctors are critical

The British Medical Association (BMA) is extremely critical of the PPP model. It points out that, over the course of a contract period of up to 45 years, medicine will have progressed in leaps and bounds, while the NHS is tied to contracts reflecting the situation in the 1990s and early 2000s. And while the government reduces overall spending from the State budget, payments under the PPP contracts have to be maintained. There will then have to be reductions in the number of staff and in the treatment of patients, says the BMA. A number of hospitals have already had to reduce their provision of treatment because the costs of the PPP contracts were greater than the funds allocated for investment. Although the Conservative-Liberal coalition promised that the NHS would be protected, 15 000 jobs had already been shed in the autumn, and more were planned (The Independent, 18 October 2010).

The BMA refers to a 2008 report from the National Audit Office entitled “Making changes in Operational PFI Projects”, which states that “An estimated £180 million [approx. NOK 1,800 million] was paid by public authorities to PFI contractors to undertake changes in 2006.” It also refers to an article in The Times which claims that the HSBC bank pocketed almost £100 million (approx. NOK 1,000 million) for running NHS hospitals, partly because exorbitant rates were charged for quite simple maintenance tasks like moving an electric socket.

5.1.3.Schools

In 2004, the UK Department of Education launched a large-scale PPP plan to build new schools, called the “Building Schools for the Future” programme. The programme was estimated to cost a total of £52–55 billion (some NOK 520–550 billion) over its lifespan. A report to the House of Commons Public Accounts Committee states that “The Department was over-optimistic in its original planning assumptions for BSF, creating expectations for the speed of delivery that could not be met.” Of the 200 schools originally planned to be completed by December 2008, only 42 had been by that date. Although the Department had hoped to deliver the programme over 10–15 years, it now expects it to take 18 years, with the last school completed in 2023.

In its conclusions, the Committee writes that “The Department’s poor planning and persistent over-optimism has led to widespread disappointment with the programme’s progress and reduced confidence in

its approach and ability to include all schools by 2023.” (House of Commons Public Accounts Committee: Building Schools for The Future: renewing the secondary school estate. May 2009)

Stopped by the new government

The new British government that came into power in May 2010 put a stop to this programme, along with other PPP projects. In a reply to questions in connection with City Council proposition 217/10 on PPPs, Oslo’s ‘finance minister’ Kristin Vinje quotes the Labour Shadow Secretary of State for Education, Ed Balls, who complained vehemently about the cancellation of the programme. This statement shows that it was not dissatisfaction with the PPP programme but the financial situation that put a stop to the funding, writes Vinje.

However, this is not true. The new coalition parties had long expressed their deep distrust of the Labour government’s PPP projects. In an interview with the Daily Telegraph on 4 February 2010, for example, the future Chancellor in the Cameron government, George Osborne, then Shadow Chancellor for the Conservative opposition, said that, “Under Gordon Brown’s PPP we get the worst of both worlds. We get all the downside of expensive and inflexible contracts, but the taxpayer is still left on the hook if it all goes wrong. We need a new approach to PPP that’s transparent and puts value for taxpayers’ money first.”

5.2 Other experience

“The brutal reality is that most private sector toll companies are a shambles.”

The Australian, January 2009

Australia has used PPP contracts on a large scale, particularly for road building projects, but a good many of these projects have failed. An article in The Australian in January 2009 summed up the situation like this: “The brutal reality is that most private sector toll companies are a shambles.”

In Australia, PPP companies recover their investments directly by way of tolls. The reason for the problems is that they were over-optimistic in their projections of traffic growth.

One of the major contractors in Australia is Mark Birns, Director of Fletcher Construction. In an interview with the New Zealand Herald on 26 November 2008, he said that “if the aim was to bring projects to fruition

quickly, making them PPPs would be a retrograde step as so much time is involved in setting up the legal framework between participants in the project.”” He also questioned whether it was possible to obtain private financing without any government guarantees under the current borrowing conditions, which anyway rule out any transfer of risk to the private sector ... Sometimes the benefits of risk transfer are illusory, he said, pointing out that the British government had to buy out Metronet, the private operator in the London Underground project... “If the transfer of risk was not complete, the true benefits of PPPs came down to an analysis of the funding costs, and there was a strong argument that the Government would be better off just raising debt, potentially through infrastructure bonds, to do the project using other traditional methods of contracting.”

In many countries, including Ireland and Slovakia, PPP projects were wound up as a result of the financial crisis. In Canada, the Auditor General in Ontario criticised the first PPP hospital in the province, and claimed that it would have cost 50 million Canadian dollars (about NOK 250 million) less if it had been built by the provincial government in the traditional way without any private partners. In the USA, there has been very little use of PPP projects to date. In Texas, a proposed road building project worth \$183 million (around NOK 1,100 million) was dropped after widespread protests. The Legislative Assembly in Texas was sharply divided on the value of the project.

The World Bank and other development banks have tried to promote PPP projects in developing countries, but it is generally acknowledged that they have failed to generate any investment. Finally, in a note entitled “A crisis for public-private partnerships (PPPs)?” (January 2009) from the Public Services International Research Unit, David Hall writes that: “The simple alternative is the traditional method of financing public infrastructure – through government borrowing to raise finance, issuing construction contracts, and then operating the facility, whether through direct labour or contractors. This remains perfectly feasible. Governments are still able to borrow the necessary money: their credit is not affected in the same way as private companies. Traditional procurement is also simpler and quicker than PPPs: attempts to maintain PPPs as a core method of funding risk delaying infrastructure projects. The desired level of infrastructure investment can thus be achieved without any use of PPPs at all.”

6. PPPs in Norway

6.1. Highway projects

In 2001, the Norwegian parliament resolved to handle three road building projects as PPPs: these were the E 39 Bårdshaug–Klett, Lyngdal–Flekkefjord and Kristiansand–Grimstad. The projects were based on the PPP company in each of them taking responsibility for 1) building a specified stretch of road on a ‘total enterprise’ basis, 2) financing the construction in return for the state paying the company for its investment over a 25-year period, 3) operating and maintaining the roads over a 25-year period in return for a payment agreed beforehand.

The Ministry of Transport and Communications commissioned the Institute of Transport Economics (TØI), in collaboration with Dovre International, to evaluate the three projects. These evaluations were published in TØI report 890/2007. At that time, only two of the projects were completed, while the third, Grimstad– Kristiansand, was completed in 2009. The Norwegian Public Roads Administration did not carry out a separate evaluation of this project after it was completed, but the website of Byggindustrien magazine says that the contractor (Construction Joint Venture E18 Grimstad– Kristiansand, a joint venture between E.Phil & Søn from Denmark and Bilfinger Berger from Germany) sustained a big loss from the project. From the government’s point of view, this could perhaps be seen as a success, but of course PPP projects cannot be based on the contractor making a loss.

The TØI concludes that PPPs bring a more efficient use of resources. This conclusion is based on the fact that the actual construction period is shorter than for other projects executed under traditional contracts. This in turn reflects the fact that PPP projects are fully financed from the outset, while other projects are only part-financed, which leads to longer building times. However, it is important to stress that this has nothing to do with the PPP model as such, and that the same result can be achieved by obtaining full financing, with the same construction time as traditional contracts.

This is also mentioned in the TØI report: “Where the total project is financed from the state budget, the whole amount is made available at once. The Public Roads Administration acts as principal and engages contractors to carry out the work in the usual way. The main difference is that the whole project can be planned and implemented without being tied to the annual budget processes. One way of doing this is to run the project as a ‘total enterprise’, which means that the principal contractor

looks after both the planning and the implementation of the project. The total enterprise approach may cover just the construction phase or it may include operation and maintenance, the latter possibly as a separate total enterprise project.

At the organisational level, this model has the same advantages in terms of end-to-end planning and predictability as an ordinary PPP project. We therefore assume that shorter construction times can be achieved here also. There is also the potential to offer incentives to reduce costs. Some of this potential may have been realised, but we have no way of knowing this.”

6.1.1. Costs

The report says that “no basis has been found for claiming that pilot projects have brought substantial savings in construction costs.” In reality, the construction costs for PPPs were higher when compared to previous reported figures and with traditional methods. The report reproduces a table based on information from the report on the replacement costs of the Norwegian highway network (Norwegian Public Roads Administration, 2004) and final project reports. The column headed “Traditional implementation” is taken from the parliamentary propositions for the projects, which are based on estimates produced by the Public Roads Administration before the launch of the PPP projects. “Estimated total PPP project costs” are a combination of the contractually agreed costs to the PPP companies and estimates of the Public Roads Administration’s own implementation costs.

	Price level	Previous figures	Traditional implem’n (state)	Est. total PPP project costs
Klett-Bårdshaug	2004	1 450	1 381	1 540
Lyngdal-flekkefjord	2005	1 350	1 193	1 400
Grimstad-Kristiansand	2008	3 900	3 475	3 550

TØI report 890/2007

For Klett–Bårdshaug, the construction costs were given as NOK 1,540 million. The costs based on previous figures were given as NOK 1,450 million, and for traditional construction, as NOK 1,381 million. For Lyngdal–Flekkefjord, the construction costs were stated as NOK 1,400 million, while previous figures give costs of NOK 1,350 million and traditional implementation NOK 1,193 million. For Grimstad–Kristiansand, the PPP

costs were given as NOK 3,550 million, while previous values were reported as NOK 3,900 million, and traditional construction at NOK 3,475 million.

In relation to Klett–Bårdshaug, the TØI writes that the estimated total PPP cost is just under 10 per cent higher than the figure for traditional implementation calculated prior to the project. However, this estimate may be slightly on the low side, as “some PPP efficiency gains seems to have been assumed.

Adjusted for this, the estimate for traditional implementation is of the same order as the actual PPP costs.” “Compared to the previous figures from the report on replacement costs, the difference in costs between a PPP and a traditional implementation is less, but PPPs remain slightly more expensive. This may be due to local cost drivers, such as large quantities of soft clay around the site.”

For Lyngdal–Flekkefjord, the calculated PPP cost is 15 per cent higher than the figure for a traditional implementation estimated prior to the project. Here again, the cost of traditional implementation may be on the low side, as efficiency costs associated with PPPs may have been added. Nevertheless, writes the TØI, as for Klett–Bårdshaug, there is no clear indication that this has actually happened. This project also encountered difficult soil conditions which were not taken into account in the estimate, and the scope of the project was expanded somewhat ‘in flight’. The extra costs are thought to be of the order of NOK 30 to 60 million, but even when an adjustment is made for these, a PPP implementation still costs slightly more than a traditional implementation.

For Grimstad–Kristiansand, the calculated actual PPP costs are at the same level as calculated for a traditional implementation prior to the project. Compared to the final costs of similar projects, a PPP implementation turns out to be slightly more economical than a traditional implementation. The high costs of a traditional implementation may arise from various characteristics of the projects that have been compared to the PPP project. Another project, Guto–Kopstad, which is comparable in size and content, has roughly the same cost level as has been calculated for the PPP project. As no final figures have been published for the construction costs, it is impossible to say with any certainty how the final construction costs compare with the alternatives. But as it is reported that the contractor sustained “big losses” from the project, we have reason to believe that the costs may have been significantly higher than calculated beforehand.

The report also says that the theory that PPPs produce extensive technical

innovation “is scarcely borne out by reality”. The theory that putting overall responsibility in the hands of a private company will mean that more is invested in the construction phase in order to reduce operating and maintenance costs “is not proven” either.

The report also states that “PPPs may cause projects to be more expensive for the public purse than they would otherwise have been”. This is because the PPP companies bear the liability for the construction costs, and the government has to pay a certain risk premium for this.

The TØI finds that “experience to date indicates that the PPP model produces a fairer distribution of risk than a traditional model.” It acknowledges that the administrative costs and other transaction costs are high, “although the trend is downwards”, but does not explain what is meant by this. The TØI report states that “the information provided for the evaluation was not sufficient to support the conclusion that private financing is cheaper or more expensive than public financing.” The reason for this is that the bulk of the risk has moved from the PPP company onto the contractor.

The report also says: “In general, the same returns should be demanded from public capital as private capital in the same type of application. Private financing in effective markets cannot therefore turn out badly for PPPs in a macro-economic calculation. The shadow factor with public funding (the tax factor), works as follows: without efficiency gains or disparities in the cost of capital, PPPs will demand at least equally large payments from the public purse.”

Whether the project is publicly financed or a PPP project, it will ultimately be paid for out of tax revenues.

The financing costs are part of the total costs. If the actual construction costs are similar, the traditional project based on public financing will be cheaper than an equivalent PPP project. The public return on each Norwegian krone invested in the PPP project will therefore be lower. The point of the ‘shadow factor’ with public funding is that some theoretical economists (including the Norwegian Ministry of Finance) believe that 20 per cent should be added to any project financed from tax revenues, because this type of financing has so-called efficiency costs equivalent to 20 per cent. There is no tenable argument for such a mark-up. And whether the project is publicly financed or a PPP project, it will ultimately be paid for

out of tax revenues. It is then irrelevant whether we factor in efficiency costs, or whether part of it is to be covered by tolls. But here again, the effect is the same whether a PPP or a traditional model is used. Because of higher financing costs, PPP projects will be more expensive when the construction costs are the same.

Professor Bjarne Jensen has estimated from the payment streams agreed between the State and the PPP companies for the first two projects that the interest rate obtained by the PPP companies is of the order of 8–9 per cent. (The companies were unwilling to publish the contract terms). By way of comparison, the State could have financed its loans at half this rate, or even less. The State would not be so stupid as to accept a fixed interest rate for 25 years. All knowledge and expectations of such situations indicate that the most cost-efficient approach is to opt for floating rates or shorter-term fixed rates. However, the interest rate risk will force the PPP company to opt for longer-term rate agreements, or to retain a larger amount of equity. The company's interest costs are then much higher than the State would have incurred (Bjarne Jensen, 2010, unpublished paper).

Professor Jensen points out that, if the interest rate for the three PPP projects is one per cent higher than with State financing, the added costs of the three projects over 25 years will come to some NOK 700 million. With interest rates two per cent higher, the figure will be twice this. As interest rates seem to be even higher in this case, the additional cost to the public purse from PPP financing will undoubtedly run into the billions.

In order for a PPP project to be profitable, it must bring significantly more efficient operation and maintenance, or as it says in the report, "Efficiency gains are thus the only weighty reason for deploying a PPP solution." However, no such efficiency gains have been documented: "Prior to the PPP purchases, the projected operating and maintenance costs were assessed. In all the projects, the stated costs from the PPP companies are of the same order as the projections shown in Annex 5." Annex 5 has not been published on the grounds that it contains business secrets, but the TØI concludes that there have been no efficiency gains in operation and maintenance in any of the projects. In some of the projects, the contractor has also put operation and maintenance out to sub-contractors, just as can be done in the traditional model.

– The PPP company's virtual monopoly on changes to the road system is a challenge.

Institute of Transport Economics (TØI)

In a PPP, the State has to pay for the risk borne by the contractor. As we have seen from examples from abroad, the government may be obliged to bear the risk anyway if the contractor goes bankrupt or is unable to meet his contractual obligations for other reasons. It is also clear that, with such long contracts, there will be a need for changes 'in flight'. The evaluation report from the TØI states that "The PPP company's virtual monopoly on changes to the road system is a challenge." "The Public Roads Administration is entitled to request changes, in response to new road policy decisions or local needs for example, but then has to negotiate services and prices with the PPP company. Initial experiences of this type of change show that it can be difficult to obtain market prices for the work." In other words, the costs of such changes will be higher than if the work had been put out to tender in the normal way. The TØI also writes that "Experience from PPP projects in Spain and Portugal shows that there will always be a need for changes in the course of the contract. Over time, these can increase the whole-life costs."

As mentioned earlier, the transaction costs associated with drawing up tender documents and following up over 25 years will be significantly higher with a PPP than a traditional implementation. The TØI reports that the stated transaction costs of the PPP companies vary between 1.5 and 3 per cent of the contract total for the principal contractor. "However, it is not completely clear whether this figure represents the total transaction costs, as some of these may be included in the contract total for the principal contractor. It is thus conceivable that the stated costs may be slightly lower than the real costs." And 1.5 to 3 per cent is higher than with traditional procurement, where the same element is typically between 0.5 and 1 per cent. The report mentions that bidders who have participated in several of the tendering procedures state that the cost of bidding went down from the first to the last tender.

The Public Roads Administration's own procurement costs are not published, but there is no doubt that these too will be substantially higher with a PPP than a traditional model. For the Administration too, the costs of a PPP may be assumed to decrease as people gain more experience. Bidders who do not succeed will have the same costs as the others. Either these costs have to be covered by the Public Roads Administration, or the bidders

have to factor the costs into their tenders in case they are not awarded the contract. In the cases under discussion, the compensation offered to those who did not succeed was purely symbolic.

If project financing is obtained for traditional projects too, there is no reason why the implementation should take longer than a PPP.

The only advantage that can be cited for the PPP projects is therefore that the implementation took less time than with individual comparable projects. However, as we have seen, this had nothing to do with the PPP model as such, and more to do with the fact that traditional projects are financed in a piecemeal way. If project financing is obtained for these projects too, there is no reason why the implementation should take longer than a PPP. It must also be remembered that the actual preparation of a PPP contract takes much longer than with the traditional model, so the total time taken to implement the project may be longer for a PPP than with the traditional model.

6.2. School projects in Oslo

6.2.1. Persbråten and Høybråten – two PPP projects in Oslo schools

The City of Oslo used PPP contracts for Persbråten, Høybråten, Bogstad and Ullern schools. SINTEF carried out an evaluation of the first two in 2009. Reinertsen AS (RE) made a comparison between Persbråten and Bjørnholt upper secondary schools in 2008. And finally, the City of Oslo's own company Undervisningsbygg provided an assessment of the experience from these school building projects in a letter dated 12 October 2010.

Reinertsen AS was commissioned by Undervisningsbygg KF to produce a report assessing how the choice of implementation model affects the total costs of investment and administration, operations, maintenance and development in a given period. The implementation models evaluated are PPP, used for the new Persbråten school, and a standard shared enterprise, used in the building of Bjørnholt school. Reinertsen AS (RE) concludes that:

- The projects have practically the same investment costs per m²
- Persbråten has significantly higher operating costs per m²
- Persbråten has been more successful in meeting energy efficiency requirements
- Persbråten has been more successful in meeting the requirement for a generic design

The Norwegian Public Procurement Act [Lov om offentlige anskaffelser] stipulates that planners should carry out whole-life calculations. For Bjørnholt, this was done in a preliminary study, but RE did not have access to any such calculations for Persbråten. It was thus impossible to make any comparison here. The report from RE shows that, when functional differences are balanced out and cost elements that cannot be compared are removed, the schools have practically the same investment costs per m2, NOK 20,599 for Persbråten and NOK 20,664 for Bjørnholt.

The report then assumes the financing costs per m2 to be the same for the two schools, because the same interest rate has been used. This is because “in principle, the financing costs will be the same whether public or private funds are used, assuming loans on normal market terms as in the case of Persbråten. This is the basis for the comparison, where an average interest rate of 6.5 per cent has been chosen for both projects. As the comparable investment costs per m2 are practically identical ... then on these assumptions, the difference in financing costs per m2 will be the same, as we find.”

In practice, the financing costs are simply not the same when a PPP is used as opposed to public financing, because Oslo can borrow money much more cheaply than a private operator. The assertions made to Reinertsen are therefore fundamentally wrong on one crucial point.

As we have seen, the maintenance costs are much higher for Persbråten. This may be partly because the PPP contract specifies a more realistic amount, but it does mean that there is no saving on operation with this type of contract. The annual costs per m2 are estimated at NOK 2,222 per m2 for Bjørnholt and NOK 2,344 per m2 for Persbråten, including financing costs, which are assumed to be virtually the same for the two schools. Excluding financing costs, the costs are estimated at NOK 548 per m2 for Bjørnholt and NOK 675 for Persbråten.

The SINTEF evaluation was also commissioned by Undervisningsbygg KF. The whole-life contracts are between the City of Oslo (Undervisningsbygg KF) and SG-finans AS (formerly Elcon finans AS) on behalf of a consortium comprising SG-finans AS, Skanska AS Eiendom, Skanska AS Entreprenør and Coor Service Management AS (formerly Skanska Facilities Management AS).

The company claims to have found a total saving of NOK 41.55 million in lower costs for Persbråten school. This is due to the lower current value of the

project costs including financing costs of NOK 43.80 million, which in turn reflect the fact that the project costs themselves are assumed to be NOK 58 million cheaper with PPP options compared to the traditional enterprise approach (NOK 262 million against 320 million). SINTEF derived at these figures from the documents relating to City Council proposition 95/05, in which the construction costs for Persbråten were estimated at NOK 260 million.

However, Undervisningsbygg stated that it was too early in the project planning phase to set a fixed price, so it quoted a risk premium of 30 per cent. This brought the costs up to NOK 320 million, and it is this figure that SINTEF used to calculate the savings. However, there is no reason to believe that Undervisningsbygg's initial estimate was not close to the truth. This is because a tender was actually submitted that was completely in line with this estimate for the PPP contract. It also turned out that the construction costs for Bjørnholt upper secondary school, which was built at roughly the same time, were NOK 48 million lower than the original budget, with almost exactly the same construction costs per m² as Persbråten.

There is therefore every reason to assume that the investment costs for the two alternatives were virtually the same. Because of the higher interest rate in the PPP project, building under public-sector management would have cost NOK 18.2 million less than the PPP solution. This is the exact opposite of what SINTEF maintains. SINTEF does not analyse the administration, operation and maintenance costs in its report, but concludes that the price level is roughly the same as in normal municipal projects, while claiming that the quality "appears to be better." As shown above, Reinertsen AS found that the administration, operation and maintenance costs were significantly higher for Persbråten (the PPP project) than for Bjørnholt (built under public-sector management).

In a letter of 12 October 2010, Undervisningsbygg pointed out that it is difficult to draw any reliable conclusions based on the limited number of PPP projects that Undervisningsbygg has carried out. It refers to the report from Reinertsen AS. "Even if the conclusion reached in that report may be considered slightly unreliable, the result of the comparison is that there are no significant differences in investment costs. On average, the administrative, operating and maintenance costs are somewhat higher in PPP projects. There is no benchmark for the Høybråten school PPP project, but there are grounds for supposing that a comparison would produce the same result for this project too."

It also refers to the SINTEF report, which concludes that both projects were

generally implemented in line with requirements. It is pointed out that the tender in the PPP bidding process for Persbråten was assessed against normal costs based on previous figures. On the basis of these previous figures, Undervisningsbygg recommended the project, but the letter notes that the approved bid was much lower than its competitors. Undervisnings bygg also writes that when it has been decided what should be built, they have no problem driving their projects forward. “We find that financing is then provided to give the optimum impetus to the projects.”

Not cheaper with a PPP

Based on experience of PPPs as against building under public-sector management, there is nothing to suggest that the municipality is better off under a PPP. On the contrary, there is reason to believe that PPP projects are more expensive, mainly because of the higher financing and investment costs, and also because the administration, operation and maintenance costs may be higher. This is in line with experience from other countries (“A crisis for public-private partnerships (PPPs)?” Public Services International Research Unit (PSIRU), January 2009). Based on information from Undervisningsbygg, there are no benefits in terms of the progress of building projects in opting for a PPP.

6.3. City of Oslo. City Council proposition 217/10 – Use of public-private partnerships (PPPs)

In this proposition, the City Council suggests making substantial use of PPP contracts in the coming years. It mentions that Oslo is a city experiencing rapid growth, with an expected annual increase in population of some 10 000 inhabitants up to 2030. This means that the municipality is faced with large investments in schools, hospitals, kindergartens and general social infrastructure in the coming years. But there would be a general need for new buildings and facilities in any case, and the strategy of using PPPs put forward in the proposition document therefore applies to building and construction in general. In order to achieve the most effective use of municipal funds, the City Council intends to use competitive tendering and develop cooperation with non-profit organisations and private companies by way of public-private partnerships (PPPs). It states that “using the PPP model, we are much better able to compare public-sector undertakings with external operators in terms of cost-effectiveness, quality and the time taken for building and renovation.”

The UK is the country with by far the greatest use of PPP contracts. Experience shows that this has not provided any economic benefit, as the City Council claims, but the exact opposite.

The City Council claims that experience from other countries shows that cooperation with private operators can bring economic gains from increased creativity, good private-sector management and common goals for the parties. Particular reference is made to the UK. As we have seen, the UK is the country with by far the greatest use of PPP contracts. Experience shows that this has not provided any economic benefit, as the City Council claims, but the exact opposite. This is why the new Conservative-Liberal government in the UK has cancelled all such contracts wherever possible.

It is said that the City of Oslo has also had good experience with PPP projects in schools. As shown earlier, the use of PPPs has not delivered any economic benefit, but has rather brought increased costs, partly because the financing costs are higher with PPP projects. In the UK and other countries, the main reason for using PPPs has been that the investment costs do not appear as debt in the municipal accounts. For the City of Oslo, which has a very good credit rating and can obtain the best borrowing conditions, this is no reason to use PPPs.

The City Council also emphasises this. Instead, other arguments are advanced, such as faster completion, a greater stress on whole-life analyses, risk sharing and less government bureaucracy. The City Council's view is then that Oslo can benefit greatly from the use of PPP solutions in major investment projects in the future. The City Council suggests three main elements that should make this profitable to the municipality: greater capacity for implementation, increased competition and more added-value in the form of new solutions.

When it comes to competition, this often turns out to be less where PPP contracts are used. These only suit large companies that also have access to financing, so there may be fewer bidders than where traditional implementation models are applied. In its report on the Oslo schools, Reinertsen AS mentions that, although there is some uncertainty, the figures are nevertheless sufficient to conclude that the PPP contract for Persbråten is much more expensive than that for Bjørnholt over the operating period. "The difference indicates that there was no effective competition for this contract, and it may also reflect the fact that the supplier market is not good enough for this type of delivery, as all of them add excessive margins of uncertainty because of the long operating period." The company adds that "With good indicators and standard specifications for all relevant services, it should be possible, by using these regardless of the form of contract and the implementation model, to reveal disproportionately high prices before any subsequent PPP contracts are entered into." In other words, it is important to ensure that the

administration, operation and maintenance costs are not significantly higher under the PPP model.

PPPs produce more bureaucracy

There is no doubt that the transaction costs, both in the preparations before signing the contract and in follow-up activities during the project, are much greater under a PPP contract than a traditional implementation model. There will therefore be more bureaucracy with a PPP, not less as the City Council claims. The Council itself endorses this view by emphasising elsewhere in the proposition that, in order to obtain the desired result of a PPP procurement, “greater demands are placed on planning and implementation. Clients therefore need to ensure that they have the necessary skills in preparing, negotiating, drawing up and monitoring contracts etc. It is absolutely crucial that these should be handled in a professional manner to ensure that such projects succeed.” The City Council also intends to set up an advisory function to assist the municipal bodies in preparing, implementing and monitoring PPP projects.

When it comes to implementation capability, there is no reason why this should be less with traditional contracts than with PPPs. Undervisningsbygg writes in its letter that we “have an organisation that is tailor-made for managing and implementing construction projects. We are constantly updating procedures, skills and contract terms to address the market that exists at any given time.” “Once it has been decided what should be built, we have no problem driving our projects forward. We find that financing is then provided to give the optimum impetus to the projects.”

There is no reason to believe that construction projects take any longer when sufficient financing has been approved.

Where it has been shown that road building projects completed under public-sector management take longer than PPP projects, this has to do with the financing, not the PPP model as such. There is no reason to believe that construction projects under public-sector management take any longer when sufficient financing has been approved beforehand. There are examples of large public-sector building projects completed well ahead of schedule and well within the approved budgets (the Opera House). It is also the case that, with a traditional implementation model, penalties will be imposed if the deadlines are not met.

The City Council mentions that PPP contracts involve a sharing of risk. As pointed out by Reinertsen AS in its analysis of Persbråten and Bjørnholt schools, the long contract duration (25 years) creates an uncertainty that the PPP contractor has to take into account in the tender. With such a long contract, there will almost always be changes 'in flight'; then the municipality will have to deal with a monopoly, as the contractor can insist on holding to the original contract. Over such a long time span, it is also possible that the contractor could go bankrupt or be unable to complete the contract for other reasons. Then the City will have to intervene, even though it is the contractor who bears the risk at the outset.

The City Council writes that its view is then that "Oslo can benefit greatly from the use of PPP solutions in major projects in the future." However, there is no attempt to document what these benefits might involve. The projects will undoubtedly be dearer, both because of higher financing and transaction costs and because there may be less competition than with traditional contracts. The City will also have to pay a risk premium as the PPP contractor will bear a greater liability. At the same time, there is a risk of having to bear this liability anyway if the contractors go bust or are unable to meet their obligations for other reasons. There is no reason why the municipality, given sufficient planning, should not be able to implement its projects equally well under the traditional implementation model.

In the financial plan for 2010–2013, investments of NOK 18,252 million are budgeted for 2011–2013. Every percentage point increase in financing costs means an increase in annual costs of almost 200 million in 2013. If the projects as a whole become 10 per cent more costly, as suggested by international experience, Oslo will have incurred additional costs of around NOK 2 billion in 2013.

7. Vista analysis

In 2008, Vista Analyse AS delivered a summary report on PPP projects at the request of the Norwegian Ministry of Trade and Industry. Vista defines PPP as “cooperation between the public and private sectors on a project or service, where the private sector bears part of the liability associated with the development and/or operation of the project.” This definition omits the absolutely crucial aspect of PPP projects, which is that the private sector takes care of the financing, as in the definition above.

As to what is new with PPPs, Vista answers that this can be viewed from at least two angles. “One is based on the introduction of the Private Finance Initiative (PFI) by the Conservative government in the UK in 1992. The other comes out of the changes and challenges faced by the public sector in Norway and other countries, and the development of so-called ‘New Public Management’. The tightening of public procurement rules has also meant that joint initiatives between the public and private sectors have to be formalised with invitations to tender and competitive bidding”. Vista states that “the Conservative government in the UK introduced the term Private Finance Initiative (PFI) in 1992. The PFI is a variant of the PPP model which includes substantial financing from the private-sector party. The background to the initiative was a lack of public funds for essential investments in infrastructure, and a desire to draw on private financing to meet collective needs. The initiative was enthusiastically adopted by the Labour government and was termed ‘the third way’, as part of an ideology based on exploiting the combination of the best from the private and public sectors rather than focussing on the contrasts between the sectors. The idea of partnership and a desire to take advantage of the private-sector partner’s skills and organisation gradually became no less weighty arguments than the need for financing.”

As reported earlier, both the National Audit Office and the Conservative Party were very sceptical about the extensive use of PPP projects and maintained that it was a way for the government to conceal the State’s true financial situation. **The new Conservative-Liberal government stopped the ongoing PPP projects**, and intends to conduct a fresh review in the spring of 2011. Nor are the PPP contracts in the UK mainly used for infrastructure investments, as in most other countries that have made some limited use of this type of contract. With the exception of the collapsed London Underground project, PPPs have mainly been used to build hospitals and schools, as described in more detail above.

Vista maintains that “international experience shows that there are potential benefits to be gained with PPPs, provided that the prerequisites are in place. Earlier implementation, shorter construction times and cost reductions are among the most important benefits. Experience shows that the potential gains may be between 10 and 25 percent compared with more traditional implementation models for running infrastructure projects. The transfer of risk, profit-sharing and genuine cooperation between the parties are critical success factors. Where the transfer of risk has not been genuine or the public-sector partner has paid for a transfer of risk that the private partner cannot influence or manage, international experience shows that the downside of PPPs can be much greater than the upside.”

The report does not cite any concrete experience where PPP projects have produced gains of 10–25 percent compared to more traditional implementation models for running infrastructure projects. What has been observed in individual projects is that the implementation has been quicker than other projects with traditional contracts. However, this has to do with the fact that the public sector has not obtained sufficient financing to complete the whole project all at once, resulting in longer construction times. It has nothing to do with the PPP model as such.

Transaction costs

Vista quite correctly notes that PPP contracts are fraught with heavy transaction costs. The report defines transaction costs as the costs of obtaining information, drawing up tender documents, specifying service quality, negotiating with potential suppliers, taking decisions, purchasing/drafting contracts, and evaluation and monitoring to ensure that the desired results have been attained, and the costs of litigation and renegotiation in the event of disagreement or non-performance.

If a PPP project is to be profitable, it is above all essential to have sufficient expertise and capacity for the production of tender documentation, negotiations and evaluations of bids, and of course quality monitoring over the duration of the contract, generally 20–30 years.

Vista therefore finds that PPPs are best suited to large municipalities and government investment projects in areas where the State has centres of expertise that can support the projects. The company sees the Norwegian Public Roads Administration, the Norwegian National Rail Administration

and the Statsbygg (which manages property on behalf of the Norwegian government) as examples of such centres of expertise. It is pointed out that PPPs are most often used in connection with infrastructure projects like roads, railways, bridges, prisons and healthcare and educational institutions. These categories ought to be best suited to PPPs in Norway too, according to Vista.

Impact on public budgets

The report says that it is not possible “to make any general statement about the overall impact on public budgets from the use of PPPs. There is no single answer to the question as to which financing solution will place the least burden on public budgets, all other things being equal.”

The State can borrow money more cheaply than private companies.

Here Vista is fundamentally mistaken. Experience clearly shows that PPP projects will be more expensive and so place a greater burden on public budgets than traditional methods of financing and running construction projects. Contrary to what Vista maintains, there is no doubt that public financing is cheaper than financing via PPPs. There is a simple explanation for this: the State can borrow money more cheaply than private companies, which also demand a return on their equity well above bank interest. If a PPP project is to be profitable, there must therefore be efficiency gains that more than outweigh the more costly financing and higher transaction costs. Both international and Norwegian examples show that this is not the case, and that PPP projects are therefore normally more expensive, in some cases much more expensive, than projects run in the traditional way. The report states that “there is no basis for singling out one form of competition or one model that is more effective than other models on a general basis.” This means that Vista does not claim either that greater efficiency outweighs the cost drawbacks of PPP projects, which lie in both the financing and transaction costs.

Vista writes that “in a macro-economic perspective, PPPs with private financing represent an alternative way of gaining access to the total savings.” It is however an alternative that works out more expensive than public financing. The report stresses that “there is no direct increase in the available resources. On the other hand, the total resources may be increased by a more efficient use of resources.”

The company is quite right that there no increase in the available resources. On the contrary, resource budgets diminish because the financing is more expensive. It is obvious that the total resources will be greater if the money is used more efficiently, but there is nothing in the experience gained from PPP projects to suggest that resources have been used more efficiently. This is then not an argument for PPPs, but rather the opposite, as there are substantial savings to be made from traditional project implementation, in both financing and transaction costs.

According to the report, experience shows that PPPs have demonstrated their advantages and give value for money in most of the infrastructure projects where the model has been chosen. **The new Cameron government in the UK has reached the opposite conclusion and cancelled all ongoing PPP projects because they are not economically viable. They also maintain that the only reason the previous Labour government launched so many projects of this kind, even though they were more expensive, was the desire for government debt to appear smaller. The National Audit Office has made the same observation.**

The report discusses Norwegian experience of PPPs. It notes here that earlier completion and shorter project implementation times, with the resulting earlier delivery of benefits, constitute a major part of the benefits gained. "Lower construction costs or whole-life costs are not documented in any of the evaluations." Vista here overlooks the much more expensive financing costs of PPPs. To outweigh these, there must then be much lower construction and operational costs. As the report itself observes, no such cost savings have been documented in any of the Norwegian projects evaluated.

Under the heading "PPPs – some economic aspects", Vista writes that: "Experience shows that the most significant impact that the PPP model can have on public budgets is that, under certain circumstances, it can result in lower overall costs for running public investment projects over the lifetime of these projects. This is true whether or not the public-private partnership includes any private investment. Where PPP contracts do not yield the intended result, the impact can be a greater burden on public budgets." However, the report cannot point to any concrete experience to document any such lower costs. It also says that "Any savings mean that more resources in the budgets can be used for other purposes, or to reduce the overall need for tax financing." It goes without saying that, if savings are made, this will reduce the need for tax financing, or there will be more

resources available for other things. The question though is whether any savings have been made, and Vista itself says in its report that there is no evidence of this. But the company goes further, maintaining that a reduced need for tax financing will in itself have a favourable impact on economic growth, because there are real economic costs associated with the collection of tax. This is a disputed claim for which there is no empirical evidence, and anyway, projects must be paid for out of tax revenues whether they are carried out under a PPP contract or under the traditional model. So it makes no difference.

Transfer of experience

Vista also maintains that the use of PPPs can act as a standard and contribute to a transfer of experience and development to other public projects. "In this case, a certain body of PPP projects where the model is appropriate, can help to make savings in public budgets over and above the possible contributions to be garnered from every single PPP project." If it is not true that PPPs produce lower costs, they cannot be used as a standard to stimulate other existing cheap projects. Instead, it will be traditional projects that can contribute to such a transfer of experience.

One of the most striking comments in the Vista report is that "when economic policy causes excessive growth in overall demand, this results in pressure on the economy (a lack of real resources), whether the money spent is borrowed from a bank or dispensed from a public budget. With effective capital markets, the real cost of capital used in public production is theoretically the same as the market price of capital for a similar project with the same level or risk in the private sector. The investment decision should therefore be the same whether the project is financed with private or public capital."

The point, however, is that there simply is not the same risk whether the project is publicly or privately financed. Private financing is more risky for the lender than where the borrower is the State, so interest rates are lower on public borrowing. Moreover, private investors have to have a certain amount of equity, from which they will expect a higher return than bank interest. A publicly financed investment will therefore always have lower financing costs than if it had been privately financed. The question the government needs to ask itself is whether the proposed investment is more viable in a macroeconomic sense than alternative forms of investment. If a project is privately financed, the cost will be higher than if the same project were financed by the State. A PPP project is thus more likely to be rejected

compared to other projects financed by the State. Vista is on the wrong track here.

Vista writes that “Almost all the PPP projects in the UK have been completed on schedule. The fact is that the schedule for the large-scale expansion of schools under the PFI scheme had slipped completely when the Cameron government shelved the project in the autumn of 2010.

In its summing-up, Vista writes that “PPPs have shown themselves to be a suitable type of contract for many types of infrastructure project. There are potential efficiency gains with this model where the essential conditions are in place.” Once again, the company is stating the obvious. Any model can be effective given the conditions that result in this. The question is whether the model has this effect in practice. Here, the PPP model has by and large failed, as the Cameron government in the UK has realised.

“Higher transaction costs can be justified where the expected efficiency gains, from reduced risk and improved processes, for example, exceed the transaction costs”, Vista writes. Once again, Vista overlooks the higher financing costs. But even then, it turns out that no such efficiency gains are realised. “The PPP model is preferable where it is more profitable in a macro-economic sense than other models.” Another statement of the obvious; the problem is that it simply is not more profitable in a macroeconomic sense.

8. Myths and allegations about PPPs

The key question in relation to PPP projects is whether they represent a method of financing and operation that is better both for the public and in terms of the services provided. The Director of Public Services International Research (PSIRU) at the University of Greenwich Business School, David Hall, has examined some of the myths and allegations about PPPs, which are intended to demonstrate their superiority but take no account of their impact on costs, efficiency, quality of service and value for money.

8.1. No alternative

One argument that is often advanced for PPPs is that there is no alternative. The authorities maintain that, because there are restrictions on how much they can borrow, and resistance to higher taxes and charges, the construction of new schools and hospitals could not be initiated without a PPP scheme. And because PPPs are a necessity, people are inclined not to worry whether they are getting value for money – because there is no alternative to compare with.

An evaluation by the European Investment Bank (EIB) of ten PPP projects in various parts of Europe found that “the key impact of the PPP mechanism was that the projects were implemented at all. In all of the projects evaluated, public-sector budgetary constraints meant that the alternative to a PPP project was no project, or at least no project within the foreseeable future.” (Evaluation of PPP projects financed by the EIB. EIB, March 2005).

David Hall notes that the lending limits have been breached in a number of countries without this resulting in any sanctions (this may be worse now after the financial crisis and the measures taken to discipline the Member States). He mentions that the collapse of a British bank (Northern Rock) in 2008 increased UK debt by £87 billion (approx. NOK 870 billion), which is more than the total value of all PPP contracts signed up to that date in the UK and the rest of the EU (the EIB's calculations show a much higher value). He also notes that taxes and charges are increased on a regular basis, so there is no need to use PPP contracts if the project is generally sensible and profitable.

8.2 Saving public money

Another claim is that PPPs are better because they do not cost the public anything. In reality, citizens have to pay for schools, hospitals and other

projects in exactly the same way as other public investments, through taxes and. The expenditure can be spread over several years and pushed into the future, which again increases the total cost because interest has to be paid. Over the lifetime of the project, it is then likely that the total costs to the public will be greater than for a project financed in the conventional way.

8.3 Sharing of risk

The sharing of risk is a major argument for PPPs. But the transfer of risk from the public to the private sector does not come free. It is possible to enter into PPP contracts that transfer the risk of delays to the contractor. However, these contracts often cost 25 percent more than conventional contracts. Hall says that it is often not worth paying the cost of transferring the risk. The International Monetary Fund (IMF) has warned governments against exaggerating the real value of this transfer of risk: "It is also possible that the government overprices risk and overcompensates the private sector for taking it on, which would raise the cost of PPPs relative to direct public investment." (International Monetary Fund, Public-Private Partnerships, 12 March 2004, page 14)

8.4 Superior performance from the private sector

The final claim is that the private sector is much more efficient in all areas than the public sector and public-sector employees. It is taken for granted that private companies can finance investments more easily and cheaply, and operate any service more efficiently than the public sector.

In practically every country around the globe, governments can borrow money at lower interest than the private sector.

These claims are false. It is not true that the private sector can borrow money more cheaply than the government, quite the opposite. In practically every country around the globe, governments can borrow money at lower interest than the private sector. Empirical studies also show that the private sector simply is not more efficient than the public sector. In 2005, the World Bank concluded that:

"Most international studies show that there is no statistically significant difference in efficiency between public and private-sector service providers." Some studies have found that the public sector was much more efficient: one study from the USA in the 1970s found that private electricity companies had consistently higher costs and charged higher prices. Studies

in other sectors have not found any systematic difference in efficiency between private and public-sector suppliers and providers.

It is constantly claimed that the construction element of PPP projects is always completed ahead of schedule and within budget, and that this is the decisive advantage of PPPs compared to the traditional model for public projects. The previous British government claimed that 76 percent of PPP projects were completed on time, compared to around 30 percent of traditional projects. An overview of PPP projects funded by the European Investment Bank (EIB) in various European countries found that the projects evaluated “were largely completed on-time, on-budget and to specification”. But the PPP projects are more expensive. **An EIB report compared the costs of PPP road building projects in Europe with traditional projects. It found that the PPP projects were 24 per cent more expensive on average than normal public road building.** In 2007, the Polish government cancelled a PPP motorway project for precisely this reason. It discovered that an A1 motorway between Grudziade and Torun could be built for € 5.6 million (approx. NOK 45 million) per kilometre with traditional contracts, where as it would cost € 7.4 million (approx. NOK 60 million) per kilometre under PPP.

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