At the time of London's bid to host the Olympic and Paralympic Games in 2012 the cost of the Games was estimated to be just over £4 billion. The costs were to be met by public sector funding of £3.4 billion, with a further £738 million from the private sector.

After London was awarded the Games, the Department for Culture, Media and Sport DCMS) and the Olympic Delivery Authority (ODA) reviewed the cost estimates and in March 2007 announced a revised, and much higher, budget of £9.325 billion. The DCMS currently report (Nov 2009) that Games preparations in all areas are currently on time and on budget, including the extensive transport infrastructure improvements being made to the Docklands Light Railway (DLR), the redevelopment of the Stratford Regional Station and the successful completion of the test of the seven-minute Javelin service.

This case study presents the rationale for the substantially increased revised figures, and asks why the initial budget was so inaccurate. This case study may be of particular interest to those studying event planning or business related topics.

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N.B. The statistics and financial information that follow are taken from the House of Commons Committee of Public Accounts report: **The budget for the London 2012 Olympic and Paralympic Games Fourteenth Report of Session 2007–08 (published April 2008), and London 2012 Olympic and Paralympic Games – Quarterly Economic Reports (up to November 2009).**

Contingency Planning

The March 2007 budget included contingency provision of £2.747 billion. This sum was not included at the time of the bid, despite Treasury guidance that budgets for all major projects should allow for a tendency to underestimate costs. Such an underestimation is clear within the context of the London 2012 bid. As of Nov 2009, the gross allocation of contingency on the project to date was £702m, leaving a balance of £1,270m available.

Taxation Issues

£500million of the contingency funds had to be allocated to coverage of 'early financial pressures' and to cover £836 million in taxation payments to the earlier cost estimates, as these tax figures had not been included in the original budget. These funds also covered an estimated extra £600m budget for policing and security, a figure that had not been budgeted for in the original bid. The ODA's programme delivery budget also rose to £570m from the original figure of just £16 million.

£500m (18%) of the programme contingency had already been spent by 2008.

Effects of the Credit Crunch

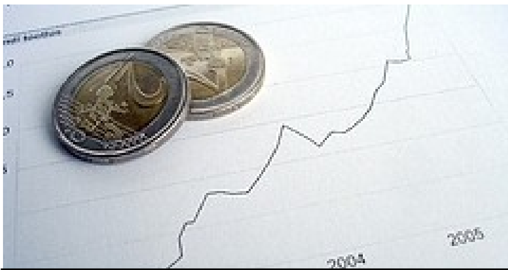
The public funding required to cover these increased costs now stands at an extra £5.9 billion, due in large part to a significant reduction in the level of private sector funding than was first thought possible. Some £4.9 billion of this increase is to be met by the Exchequer and £675 million by the National Lottery, bringing the total Lottery contribution to £2.175bn.

Land Sale

Post-Games disposal/sale of Olympic assets will determine whether some of the costs to the public can be recouped (most likely via sale of Olympic land).

Private Sector Investment

At the time of the bid, private sector funding stood at an estimate of £738m. This figure was revised to £165m by 2008 (less than 2% of the total funding). Alarmingly, the Olympic Village had been expected to be completely funded by the private sector, but the Government have now allocated £175m public funds to the project.



Revised budget = revised legacy?

The legacy impact of the Games, most specifically to the regeneration of East London, cannot be achieved without adequate financial investment. The ramifications of revising the budget puts more pressure on the public sector and may compromise the legacy and vision of the Games. One is now invited to consider the most significant financial ramifications of poor financial bid management on the Games themselves and on the public sector who have now had to shoulder the bulk of the spiralling costs.

The fact that foreseeable requirements for public sector funding were excluded from the estimates at the time of the bid is a valid and ongoing concern.

Why did this occur? Was it simply poor management? This gave an unrealistic picture of the costs that the public sector needed to meet in order for the Games to be held in London.

Contrary to good practice, the Department did not budget for a programme contingency (£2.7 bn). This is because the scale and complexity of the project was simply not appreciated at the time of the bid.

The costs of tax and security bill now stands at £1.4bn but was not even considered in the original bid.

The revised public sector funding package of £9.325bn does not include all of the activities on which delivery of the Games and its legacy depends. Crucially, it does not include acquisition of land for the Olympic Park, wider transport link costs and the cost of Govt depts. Involved in the Games. Such costs need to be calculated into the final economic impact figures for the Games.

The Department has confirmed that the public sector funding of £9.325bn will not be exceeded and the Committee will hold the Department to account against this figure.

Despite the £5.9bn increase in the public funding for the Games, specific assurances of delivery based on return for this expenditure and the current budget cannot be reconciled to the commitments in the original bid.

Clearly, transparency and accountability of all financial decisions is required. The Department should provide:

- a statement of what will be delivered, including the legacy plans and
- benefits for the programme as a whole;
- provide an assessment of progress against that baseline in its annual reports to Parliament; and
- show how any subsequent changes to the plans reconcile to the baseline
- and support them with a clear audit trail.

Significant revisions for private sector contributions have increased the estimated burden of the public sector to £748m.

In addition to increased financial burdens placed on the public sector, further burden may have to be shouldered as the absence of legacy plans is making it harder to attract private investment. Estimated private sector contribution has fallen by £573m. Selling off Olympic land after the Games to private investors may make up some ground in recouping public funds.

Overall, a total of 10,500 people have been employed on the Olympic Park since April 2008. During that period on average one in five of the construction workforce have been local people from the five Host Boroughs. 30,000 workers will be employed on the Olympic site over the lifetime of the build

The National Lottery is providing £2.175 bn (23%) of Olympic funding, but the estimated £675m reimbursement is reliant on the sale of property to the private sector after the Games.

The Department is aiming for wide ranging legacy benefits from the Games, but there is no basis on which to measure achievements.

Any well-designed project should have designed an impact study to measure the impact of their programme. No such study exists for the Olympic Games in terms of measuring legacy.

> The largest single increase in the original bid was the £2,747m provision for programme contingency.

Possible Explanations for the Discrepancy in the Original Bid

The DCMS denied that it had deliberately excluded costs from the original bid document, in order to help win the Games. It instead claimed that bid estimates had been prepared at a time when it was not certain that the Games would be awarded to London, that the Olympic land was not yet in public ownership and detailed plans for the venues had not been drawn up; thus, it would have been impossible to gain a complete and accurate picture of the overall budget for the Games. This did not, however, explain why apparently basic forecasts associated with contingency planning, wider transport links and security provisions had not been considered when it would have fallen well within the capabilities of a competent event planning team to do so. The DCMS nevertheless strongly refuted the possibility that their intention had been to deceive anyone.

HM Treasury guidance recommends that budgets for major projects include a contingency to allow for **optimism bias** (that is, the tendency for the costs of projects to be underestimated). Clearly, optimism bias played a role in the London Olympic bid. Following a detailed and quantified risk analysis, the DCMS and ODA considered that the new level of financial funding for contingency planning was now prudent and realistic, but that the biggest risks remained as the immovable deadline of the Games, and the avoidance of cost escalation at the end of the programme. This would include possible inflationary risks such as construction price inflation.

One of the largest potential explanations for poor financial forecasting might be explained by confusion over taxation status.

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Following HM Treasury confirmation that the ODA would, in fact, not be eligible to reclaim

VAT, tax liabilities of £1,173m had to be accounted for in a revised budget.

The insubstantial budget allocated to the provision of security remains a confusing issue. It is unclear why, in today's political and social environment, the threat of security violations and terrorism could not have been taken more seriously from a financial point of view by the London bid team. Whilst it is true that original security estimates included £190 m for site security during construction (a figure which increased to £268m in the March 2007 budget), this figure nevertheless rose exponentially to include an extra £600m for policing and wider security A further £238m was also provided for security funding in the contingency fund for the project

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How the Credit Crunch Has Affected Funding for the Games

Perceptions relating to the effects of the economic crisis are mixed, with some observers praising the DCMS and ODA for on time and under budget delivery of central aspects of the Olympic build, with transport, stadia and overall construction only a reported 4 days behind schedule. The recessionary impact on inflation has positively impacted the Olympic budget by driving down construction materials costs.

The effects of the economic crisis have detrimentally effected development of the Games, as no private sector funding could be secured for development of the Media Centre or Olympic Village. The DCMS and ODA have been forced to siphon funds form the contingency fund (never a part of the original bid) to finance these developments In addition, the ODA were forced to write-off a further £12.5m caused by the collapse of a deal with contractors Lend Lease (£5m) and media centre design that could not be completed due to inadequate investment (£7.5m). Despite such financial difficulties, the ODA have been criticised for significantly raising bonuses paid to external consultants during this period.

It is possible that smaller sports might fare the worst; whilst cycling and rowing have been allocated combined funding of £54m in the run up to the 2012 Games, smaller sports will receive a fraction of this. For example,

SnowSport GB, the official governing body for snow and ski sports, received only £800,000.

Both Summer and Winter sports have been hit with funding cuts as a result of the recession.

The Olympic Effect

Economists often voice scepticism about the economic benefits of hosting 'mega-events' such as the Olympic Games. Their rationale for such scepticism rests on the fact that such as event appears to entail considerable costs to the public, yet appear to yield few tangible benefits. Regardless, one might observe that policy-makers and the population of a country (if informed correctly about the financial pressures that are likely to be exerted on the public purse strings, presumably!) tend to remain enthusiastic about such an event.

Rose & Spiegel (2009) attempted to reconcile these positions by examining the economic impact of hosting mega-events such as the Olympics for the host country. It was found that hosting a mega-event such as the Olympic Games exerted a statistically significant and positive impact on national exports, which is permanent in nature, and of notable size; trade appears to be around 30% higher for countries that have hosted the Olympics when compared to those that have not. Interestingly, however, the effect of a country bidding for the Games (regardless of success) appears to exert a very similar economic impact, on exports, leading to a conclusion that the 'Olympic effect' on trade is attributable to the signal a country to others when bidding to host the games (in terms of political, economic and financial stability), rather than the act of actually holding the mega-event for which it bid.

FIND OUT MORE

House of Commons Committee of Public Accounts report: The budget for the London 2012 Olympic and Paralympic Games Fourteenth Report of Session 2007–08 (published April 2008)
http://www.publications.parliament.uk/pa/cm200708/cmselect/cmpubacc/85/85.pdf

The Olympic Effect. Andrew K Rose, Mark M Spiegel:
http://www.nber.org/papers/w14854

London 2012 Olympic and Paralympic Games – Quarterly Economic Reports (up to November 2009). Department for Culture, Media and Sport
http://www.culture.gov.uk/reference_library/publications/6454.aspx

London 2012: Stuck on the blocks? Progress on construction is good, but there are doubts over the Olympics' legacy and worries over security. Merrick, J. The Independent on Sunday. Sunday, 19 July 2009
http://www.independent.co.uk/news/uk/home-news/london-2012-stuck-on-the-blocks-1752291.html

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