



**PAC chair
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firms the
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While we have been waiting for Gordon Brown to become prime minister, the Private Finance Initiative, a policy closely associated with his reign at the Treasury, has been in the public spotlight. Ten years on, the political and economic environment has changed dramatically, so this is a good time to undertake a thorough review.

Since May, the PFI has been the subject of no fewer than three largely critical reports from the National Audit Office, an investigation by the Commons' Public Accounts Committee and two pieces of guidance from the Treasury.

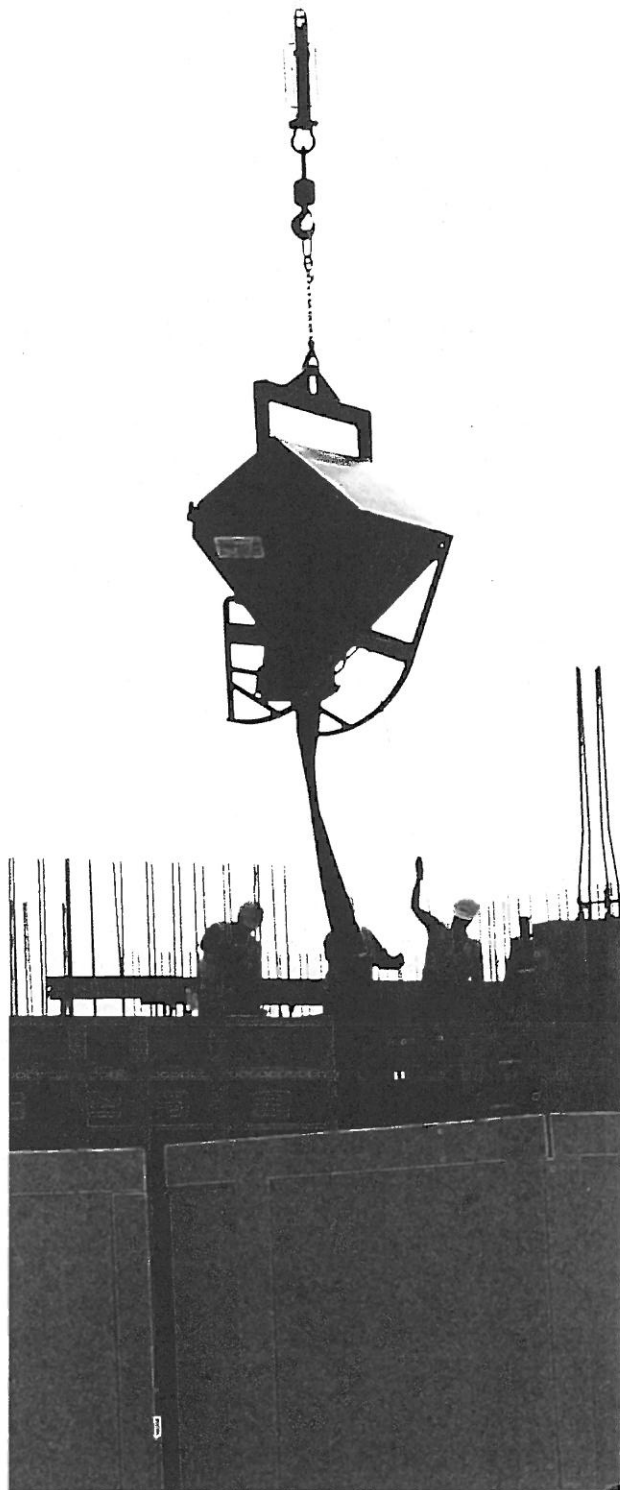
There has also been a definite mood shift as the market comes to grips with various regulatory modifications, such as the impending changes to the accounting treatment of the PFI. This will bring many schemes on to the government's balance sheet, with serious implications for departmental budgets and a knock-on effect on the Comprehensive Spending Review. At the same time, changes in European Union procurement procedures for complex contracts such as the PFI will kick in, adding even more time and cost to the bidding process.

Combine this with the strain from the conflict between long-term and inflexible PFI contracts and a rapidly changing policy environment, fewer projects in the pipeline and a shortage of bidders — and you go some way to explaining the unease in the market.

Questions about the market and the PFI are addressed by the Public Accounts Committee May report, *Update on PFI debt refinancing and the PFI equity market*. This clearly states that companies are making too much money from both the refinancing of deals and from trading in equities on the secondary market. Indeed, the PAC chair, Conservative MP Edward Leigh, has called PFI companies the 'unacceptable face of capitalism'.

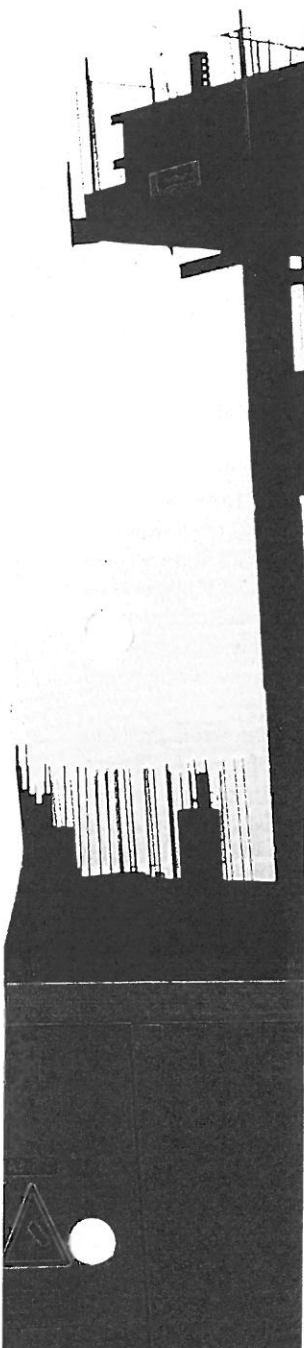
The first conclusion of the PAC report blames local public sector officials who 'lack commercial awareness' and need more training. But is it really that simple? A closer examination reveals that the real culprit is the market, and how it behaves.

The PAC report is uncompromising in its criticism of PFI refinancing and the poor deal this represents for the public. For example, the four projects with the



The Private Finance Initiative has had more than a decade to prove its worth for public services. Dave Prentis explains why it has been tested and found wanting by numerous official bodies

PFI in the sky



highest investor returns made between 56% and 71% returns for their shareholders within a few years of the award of the contracts. This amount is so high that the National Audit Office has questioned whether investors will have sufficient incentives left to perform the required services and fund lifecycle maintenance.

Following an agreement in 2003, the private sector is supposed to share any refinancing gains with the public sector on a 50:50 basis. For projects that predate that, it is supposed to follow a voluntary code and give 30% of gains to the public sector. But refinancing can also load more risk on to public sector bodies. For example, some have accepted longer contracts to lower their payments, without assessing whether the service might still be needed after so long. Others have lowered their payments rather than taking a more certain lump sum upfront.

The PAC is also critical of the way companies buy and sell their equity stake on the secondary markets — typically about 10% of PFI funding. It questions whether profits from equity sales should not also be subject to a public gain share and implies that companies might be trading in equities, rather than refinancing, to avoid sharing their gains.

What is perhaps most surprising is that PFI policy can still get it so wrong after ten years, 750 signed projects with a capital value of more than £56bn and payments totalling £170bn up to 2032.

Unison, the Trades Union Congress and indeed the Labour Party have all called for a review of the PFI. Instead, we have a monoculture, where it continues apace without sufficient reflection, allowing errors to be amplified and repeated over and over again. And all the time the government appears to believe that there are technical solutions to the problems that arise, such as affordability, value for money, inflexibility, too few bidders and the balance sheet treatment.

While the PAC report blames local officials, it also reveals a far more worrying approach to markets that underpins much of government policy on public services. The report tells us that there was no deal on gain sharing from refinancing at the outset of the PFI because: 'The Treasury was influenced by market considerations, such as the possible risks that sharing arrangements might affect the private sector's interest in bidding for the early PFI contracts.'

And, worse still, in one case, the local officers — the chief executive and finance officer — had asked for a refinancing clause in their contract but were forbidden from having one by the Department of Health. This was the Norfolk and Norwich NHS Trust, one of the first PFI hospital contracts, and the DoH was worried that any such clause would deter other entrants to the market.

The Treasury goes even further to protect the PFI companies from market forces by exempting them from sharing the gains from refinancing where they bear interest rate risks on their loans and where they have not achieved the rate of return assumed in their bids. Even the NAO says the latter 'can appear overly generous to investors'.

So while the PFI exists in a market, it is not a free market — it is a market regulated by civil servants

whose objectives include encouraging market development. In the case of Norfolk and Norwich, the immediate interests of the hospital and its community were sacrificed to the greater interest of developing a market for the PFI. Not much consolation for the citizens of Norfolk, where the hospital has had a deficit and the knock-on effects of the high PFI payments have been felt throughout the local health economy.

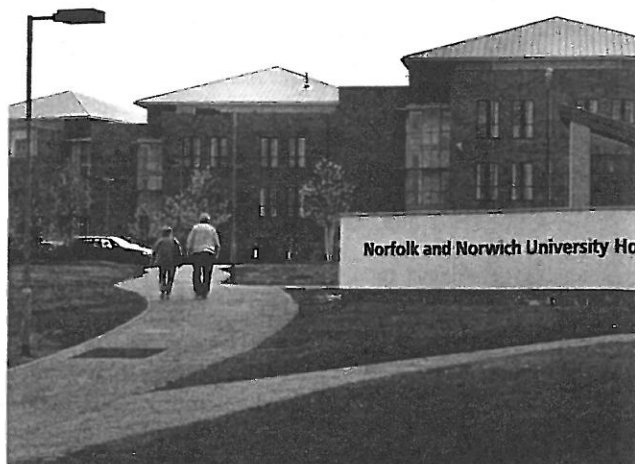
And as the equity stakes of PFI buildings are traded on the secondary market, we often no longer know who, exactly, owns our schools and hospitals. One company, Innisfree, for example, runs 47 infrastructure projects with a capital value of £8bn, including the Norfolk and Norwich hospital. Its chair David Metter has argued that 'investors should be free to take their own profits' and 'these are not public assets but private sector concessions'.

But none of this is the fault of either local officials or of the PFI consortiums, which are doing what market players do — making as much money as they can from any given deal. The fault lies with a government policy that has brought the workings of the market into public services and expects public officials to be deal-makers.

One problem that is not examined in any of the reports is the impact of the PFI on the workforce that delivers the services at the centre of most projects. Thousands of workers have been transferred from the public sector to the employment of contractors. To the Treasury's credit, it has declared that value for money should not be at the expense of the workforce. However, until someone monitors what has happened to staff in operational contracts, we cannot be sure whether this objective has been fulfilled. The evidence we have at Unison is that a two-tier workforce still exists.

The question that Brown has to answer is whether these are transient problems that can be fixed or, as Unison believes, that they are intrinsic not just to the PFI but to trying to run public services through market mechanisms. In this case, it is the policy that has to change. The market for the PFI should serve as a warning for what happens when markets are allowed to operate public services.

● Dave Prentis is the general secretary of Unison



Deal or no deal? The interests of the Norfolk and Norwich hospital came second to the greater interest of developing a PFI market

PHOTOGRAPHS BY JOHN BOWLING