A roaring failure

Private finance deals in public services have led to staggering corporate profits

Two years ago I accused the British government in this column of nine kinds of fraud and false accounting, arising from its private finance initiative. If any of these charges were false, I suggested, the chancellor of the exchequer should repudiate them. If he failed to do so, the Guardian's readers should conclude that he had no defence to offer.

Neither the chancellor nor anyone else in the government responded. Since then, several reports laying down even graver charges have been published. The government has ignored them, and the opposition has left it in peace. The Conservatives invented the private finance initiative, so they are silenced by their complicity. The Liberal Democrats have challenged some of the details of the scheme, but not the principles behind it. The trade unions, the Greens and Plaid Cymru oppose it, but if a policy doesn't divide the major parties, it doesn't make the news. Public bodies, which depend on money from the initiative, won't criticise it openly. We listen for informed dissent, but we hear only the great shuffling sound of the establishment closing ranks. Corporations, with the Treasury's help, are robbing the public of tens of billions of pounds. And they are getting away with it.

The private finance initiative is supposed to allow the government to commission public services it wouldn't otherwise be able to afford. Private companies put up the money, build the new prisons or hospitals or underground trains we need, and run them for the next 25 or 30 years. The government pays them the rent and service charges. By this means, the Treasury claims, new money is poured into public services.

As the private sector is more efficient than the public sector, they can run our public services more cheaply than the state could.

That's the theory. The practice, as innumerable studies have shown, is rather different. Instead of being led by public need, many private finance initiative projects have been designed to generate as much private profit as possible. In some cases cheap schemes, such as the renovation of a hospital, have been rejected because they are insufficiently profitable, and replaced with more lavish projects, such as demolition and rebuilding. The Walsgrave hospital in Coventry, for example, which was to have been refurbished at a cost of £30m, was instead knocked down and rebuilt at a cost of £330m, solely in order to make the project attractive to private companies. In other cases the contracts have been so generous that the companies have been able to extract staggering rates of return. The consortium which built Altcourse prison in Liverpool broke even two and a half years into the 25-year contract: it is now enjoying 22 years of pure profit. The companies which built the Norfolk and Norwich University hospital were able to extract tens of millions of pounds from the scheme through a technique called "refinancing" before the hospital had even opened.

And because, for any company, profits must come before people, many of these projects offer far worse services than their publicly funded equivalents. Beds are crammed together in hospitals which look and feel like giant morgues; operating theatres are flooded with sewage; children try to study in permanent building sites; underpaid prison guards sign off sick and look for work elsewhere. The experiment keeps failing, but the government keeps repeating it.

On those rare occasions when ministers condescend to answer their critics, they extract from this mess the handful of projects which appear to offer value for money. The sector they like to talk about most is highways. In 1998 the National Audit Office reported that the first four privately financed roads commissioned and built in the United Kingdom would save the taxpayer around £100m. If you ask a minister a question about hospitals, he will give you an answer about roads.

But even this success now turns out to be a fake. A report published last week by the Association of Chartered Certified Accountants* reveals that the figures with which the National Audit Office was working bear about as much relation to reality as an episode of Friends.

Before explaining what they found, it is worth explaining what they didn't. Most of the information they needed is withheld from the public. Outrageously, we are permitted to see neither the business case for the privately financed roads, nor the contracts between the corporations and the government. So the report's authors, like the National Audit Office, have been groping around in the dark. The government claims that this information cannot be released because it is “commercially confidential”, but it now turns out that the government instructed the private companies not to publish it. When information like this is kept from us, you know it has something to hide.

But the darkness has begun to yield some of its secrets. The association’s researchers studied the first eight privately financed roads in Britain: schemes such as the widening of the A1 and the A1-M1 link, and the construction of new sections of the A30 and A69. The private consortia which built them are paid by the government according to the number of cars and lorries that use them.

The researchers discovered that by 2002 the roads companies were making an average operating profit from the eight projects of 68%. This, the authors point out, is likely to be an under-estimate, as several of their sources of income are hidden from public view. What it means is that only one-third of the money we are paying for these roads is used to run and maintain them. In just three years, the Highways Agency paid out £618m to the consortia – more than the entire capital cost of the roads (£590m). In other words, the government could have paid for all eight schemes itself. As it is, the contracts, which last for 30 years, will cost us £6bn.

This remarkably bad value for money has been disguised by a couple of clever accounting devices. One of them is the high discount rate used by the Highways Agency. It assumes that the value of the invested capital will decline by 8% a year. The Treasury’s guidelines say the rate should be 6%. More importantly, much of the cost the companies are presumed to carry takes the form of something called “risk transfer”. In principle, if traffic growth is lower than forecast, they risk losing money. But the risk has been massively over-estimated. Even when traffic has fallen short of the companies’ estimates, they have made a thumping profit. And, of course, this risk does not exist when the public sector builds a road: the government does not lose money if the volume of traffic is low. This cost, in other words, has been invented to make the private finance initiative work.

So even the government’s great private finance success turns out to be a roaring failure – for everyone, that is, except the corporations and the banks. The only interesting question is this: for how much longer are we prepared to let it go on?

* *Evaluating the operation of PFI in road and hospital projects, by Pamela Edwards, Jean Shaoul, Anne Stafford and Lorna Arblaster*