Public costs, private gain

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Public costs, private gain | Chris Edwards | □□□□Comment is free | □□□□guardian.co.uk

Chris Edwards is one of the foremost experts on the harm caused by PFI in the UK. He wrote on Comment is Free last week when I was in the US, so I missed it then and correct it now. As he noted:

Earlier this week, the economic affairs committee of the House of Lords published a report on "Private finance projects and off-balance sheet debt". An outcome of an inquiry initiated in July last year, the report will be of interest to the non-specialist. To the specialist, it is woefully inadequate.

In its abstract, the committee contrasts two views of PFPs: one favourable, the second distinctly unfavourable. The committee is generally favourable to PFPs, but concludes that "the dearth of hard data â€šÃ„¶ encourages assertion rather than analysis," and that "this needs to be remedied".

Surely after more than five months of work, the committee should have substantially begun to provide the remedy and fill in the data gaps? There is a shortage of data, but the main report fails to draw on the data painstakingly collected by a raft of researchers — such as the Cuthberts, Pam Edwards (no relation), George Monbiot, Allyson Pollock, Jean Shaoul and myself. A little of the hard data is in the 326 pages of evidence in volume II, but much of it has not been used for analysis in the 41 pages of the main report (volume I)

This is disappointing for two reasons. First because this is the first parliamentary inquiry on the topic since 2000. Second, because PFPs are important. As the committee points out: "There are now about 800 [PFPs] in being in the UK with a capital value of about £64bn", with PFPs being particularly important in health (delivering 70% of hospital schemes) and schools (about 60% of new schools having been delivered as PFPs). It is worth noting that this capital value understates the burden imposed on the public purse by PFPs, since the annual future repayment stream on these 800 projects is at least £200bn.

Amazing then that there has not been a report for a decade. And as Chris notes:

Could these projects have been financed by the public sector more cheaply? The committee does not answer this question, instead misleadingly stating that "PFPs enjoy a generally good reputation for delivering projects on time and within budget". However, PFPs are bound to have a better chance of completing within a budget if the price is high, and experience shows that PFPs have been significantly more expensive than state-financed projects.

The reason for this is that, over the past ten years, the private sector's cost of capital has been between 2 and 5 percentage points above the average annual interest rate on government bonds of 4.8%. The evidence for this is given on page 156 of volume II, and yet the main report quotes David Metter of the Public-Private Partnerships Forum as saying that the difference is only 1.5 to 2 percentage points (paragraph 28, volume I).

Metter is wrong because he ignores the very high percentage profit accruing to equity shareholders on PFPs. This mistake is somewhat surprising since he is the founder and chief executive of Innisfree, one of the largest of the PFP investors. According to its website, Innisfree has invested £923m in 53 projects with a total capital value of £10.9bn, £5.3bn of which is in hospitals. Between 1998 and 2008, the annual rate of profit (with directors' remuneration included in the profits) for the Innisfree Limited shareholders between 1998 and 2008 was more than 200%.

This high rate of profit on PFP equity is sufficient, in general, to push the overall cost of capital to between 2 and 5 percentage points above that of the public sector.

And then, for me, Chris gets close to home:

What is the effect of the private sector's much higher cost of capital? As an example, look at the Norfolk and Norwich University Hospital, one of the earliest and largest of the PFI hospitals. As a result of the PFI contract, the rent paid to the company involved (Octagon Healthcare) is two and half times as much as the rent under a publicly financed procurement. This higher rent is payable to the end of the contract (in 2037).

But this higher cost of capital is not the end of the story. There are other costs ignored by the committee in its report but itemised on page 157 of the evidence.

In conclusion?

There is, then, little doubt from the hard data that PFPs are poor value for money. Yet, this is not the conclusion of the committee's report. Unfortunately the PFP contracts have generally been drawn up with the inclusion of such high cancellation payments that it is uneconomical for the government to buy back the contracts. This means that if hospitals have to be closed as patterns of treatment or population distributions change, the ones most likely to be closed will be the state-financed ones, since the rent of the

PFPs will have to be paid — whether or not they continue to be used.

The attraction of PFPs for Gordon Brown and the Labour government since 1997 has been that PFI investment has not generally appeared in the total of public sector debt. Brown's upper target for public sector debt to national income was 40%, ridiculously low by international standards. PFPs enabled the government to hide much of the repayment liabilities and, until the crisis, get under the 40% target.

We have already seen that the future annual payments due on PFPs amount to more than £200bn. At a conservative estimate, **at least half of this is an excess cost attributable to private finance**. But, again, you will not find this hard data in the committee's main report.

My emphasis added.

But this is an appalling New Labour legacy. Out with the New, bring in the old I say.