

New towns, old scam?

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Labour says it wants to build new towns. But if Rachel Reeves funds them through PFI-style private finance, those towns could be financially crippled from the start.

PFI was sold as a clever way to build public infrastructure without increasing government borrowing. In reality, it was a fiscal illusion. The state still paid, but paid far more than it needed to. Schools, hospitals and many other public assets were locked into contracts in which every repair, alteration and service had to go through private contractors at inflated prices.

That is bad enough when it applies to one hospital or one school. Applied to whole new towns, it could be disastrous.

New towns need roads, drainage, schools, health centres, public spaces and utilities. If those are all wrapped in private finance contracts, the people who live there will inherit the cost for generations.

This is not prudence. It is financial engineering, and it will have a very real human cost.

<https://www.youtube.com/watch?v=Y1XHeBuw7rM?si=52CgugtlpMBEM75>

This is the audio version:

https://www.podbean.com/player-v2/?i=h3ufh-1addacc-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

The Debate Ammunition for this video is available here.

This is the transcript:

Rachel Reeves is considering using the private finance initiative, PFI, as it was once called, to fund Labour's new town programme, and that will be a disaster. A disaster for the country, a disaster for the places in question, a disaster for the people who might live in them, and that therefore makes this an issue of national significance because this is going to be a burden on us all for decades to come.

PFI is then back on the government's agenda more than a decade after it was last used. PFI was Gordon Brown's great financial scandal, and remember that he was Chancellor of the Exchequer from 1997 until 2007, when he became Prime Minister, and it was him, above anybody else, who imposed the enormous cost of the private finance initiative on this country.

George Osborne, in one of his rare moments of insight, effectively abolished it whilst he was Chancellor of the Exchequer. The programme was effectively not used after 2015, except in Scotland, where it died out a little later. That was because even the Conservatives could see the damage it caused. Labour now seems to think otherwise.

New towns need hospitals, schools, roads, utilities, and housing, and all of these are potential PFI targets. Even lampposts have been subject to PFI projects in the past and have been financed that way, and that is utterly absurd. So, in this video, I want to explain what PFI is, why it's wrong, why it's costly, and why using it is, quite straightforwardly, economically illiterate.

So let's be clear what a PFI contract really is. It is issued by the government to a private contractor. The private contractor builds an asset, whether it is a building, a road, a bridge, or anything else, for the government. They then rent that asset that they have built back to the government for up to 30 years. The government only then has the option to buy it.

In addition to renting the asset to the government, the private finance initiative contractor also maintains the building. They paint it, repair it, adapt it, and keep it fit for use, and the government is allowed to do nothing to it. The PFI contractor has to do everything.

Both of these arrangements are meant to reduce the government's risk and shift it to the private contractor, who is presumed to build a higher-quality asset because they know the risk of maintaining it is theirs. However, there is no evidence that this really happens. The charges that contractors can make for building maintenance are very often so high that, in most cases, it seems no such risk transfer occurs.

Building new towns means funding every piece of infrastructure that they require from

scratch. Now, I'm not discussing at this moment whether we do need new towns or not. Labour says they're going to build them, and maybe we do require some, but those new towns require roads, drainage, utilities, schools, health centres, public spaces, and all the other things that make it possible for a new town to function. And each of those assets is going to be subject to a separate building contract, and so each of them could be subject to a separate public finance initiative contract because the first thing that a PFI contract does is usually construct a building.

What it then does is guarantee that the person who constructs the building continues to own it. And what they then do is continue to service it. In other words, they maintain it, they paint it, they repair it, they provide the services within it, and it is this second element in particular, which is extraordinarily complicated and costly as a result, because the PFI operators want to guarantee that they have covered every eventuality in the work that they're going to undertake, and as a result, they tend to massively overprice it.

This then gives rise to a massive transfer of value from the state sector to the private sector, and the bizarre thing is that we know that the consequence has been significant overcharging to the state. But despite that, Rachel Reeves appears intent on reviving the private finance initiative, and she says, this is the only way to fund this new town programme. My argument is, if this is the only way to fund that programme, we don't need that programme because this will be a massively costly mistake that will last for 30 years or more.

And why is that? Well, that's because that's how long these contracts often last. And the fact that there is a supposed transfer of risk from the state to the private sector is always an illusion because the private sector charges excessively for that risk transfer.

The consequence is that the state simply overpays for whatever risk there is in building a school, a hospital, or whatever. The evidence is that it massively overpays. Even the Office for Budget Responsibility has called this supposed transfer of risk from the state to the private sector, a fiscal illusion.

And in fact, the official justification for PFI has always failed to justify the price paid for this risk transfer. If costs have overrun, that was not the contractor's problem. They always argued that costs overran, not because they made a mistake, but because the government had changed the specification for a building, whatever the project was, before it had been completed, and therefore the state had to pay. They never picked up the burden of risk as a consequence, and governments cannot let schools or hospitals fail. And therefore, even if the contract is a bad one, the public never really gets the benefit of the risk transfer because they've got to pay anyway, because there is no alternative school or hospital for people to pay for.

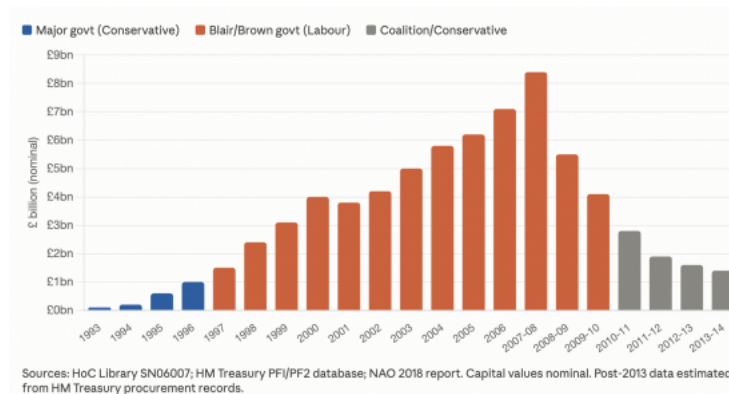
That has been proved time and again by what has gone on. And we saw it, for example, in Liverpool, when the Carillion company collapsed in 2018. They were a major PFI

provider. They were midway through building a new hospital for Liverpool at the time. That hospital project sat moribund for years, and the people of Liverpool suffered as a result.

If it had been built on a direct contract and if it had been built by the state itself, and remember, the government used to build its own buildings, employing its own labour, none of that delay would have happened. There would have been a better new hospital in Liverpool at lower cost, much earlier than if a PFI contract was used, especially when that PFI contract failed. There was no risk transfer in the Carillion contract for building the hospital in Liverpool. It only created risk, and that is true of almost every PFI contract.

And why is that? Well, that's because PFI contracts require a rate of return for the contractor of between 12% to 15% per year. That's the profit margin they look for. The government's cost of funding at the moment are around four to 5% a year. The profit margin the government therefore requires to cover its funding cost is vastly lower than that which is required by the private sector. And that is the difference between the two. And that is why PFI is so expensive. They're simply extracting excessive profit compared to what the state can do, and there's no evidence that they are any more efficient than the state in building projects.

So what did happen with PFI? This chart shows it. This is the value of PFI contracts signed each year from the mid or even early 1990s, right up until about 2014, when they were fading away.



You will see that Gordon Brown signed most contracts. In fact, the peak year for signing PFI contracts, more than £8 billion of them, was the last year that he was Chancellor of the Exchequer, and the first year when he was the Prime Minister. That was the disaster he delivered. His legacy was the excess cost that resulted from this.

Around £60 billion of building projects were funded by PFI. And why? Well, go back to that chart. Look at it. It was because both the Tories in the 1990s and then Gordon Brown, particularly, were obsessed with the idea of taking the cost of funding government investment off the government's balance sheet so that they could meet

their fiscal rules with regard to borrowing.

They claimed that the cost of building an asset using PFI was an expense they did not have to recognise in the government's accounts now, and therefore it wasn't included in borrowing. And as a result, they came up instead with this idea of PFI contracts. Those £60 billion worth of properties will cost, by the time they've been paid for in full, including some service obligations, around £310 billion. That is five times more than the value of the assets that were built, and no building costs that much to service. Let's not pretend it does.

This is ridiculous. This is crazy. The government was just handing out money to the private sector for no good reason, and the existing contracts are going to last until the 2040s. If Rachel Reeves goes back to these absurd things, we'll be paying for them until the 2060s and beyond.

So this was why everything went wrong. And the fact was that there were crazy examples of those contracts not working.

There was evidence that a school was charged £25,000 for three garden parasols under its PFI contract.

A hospital paid £5,500 for a single replacement sink.

I remember years ago, talking to a head teacher who was complaining that changing a light bulb cost around £100 under his PFI contract, and he, or no member of his staff, was allowed to replace the light bulb themselves, even though they could adjust it on a stepladder, get the bulb down and replace it with another one. That was not allowed. They had to pay £100 to do it.

Every repair, every change, every adaptation has to go through the contractor at their price, and that has resulted in the public sector being fleeced. And the NHS has found itself particularly vulnerable to this. But in Scotland, it was education that suffered the burden.

And when we talk about the NHS, £13 billion of hospitals were built using PFI, but the cost might be £80 billion by the time they've eventually been paid for. That is a massive excess burden on the health trusts involved. This is why I distrust everything about PFI. When we needed to buy public services, we bought an arrangement to fund private sector profits, and this will be replicated if Rachel Reeves now uses PFI to build a new generation of new towns.

The fact is that there is an alternative to all of this. Modern monetary theory starts from a basic truth about how currency works. The UK government, as the creator and issuer of sterling, can always fund its own investment. It can create money that is required to fund any investment, so long as the resources to build the project in question are

available, and of course, that is a precondition for PFI as well. It doesn't need to borrow money from private markets to build new towns or their infrastructure. That's the key point. When government spends it creates the money and that is how our monetary system actually functions.

PFI was built on the assumption that government is like a household and it must borrow money to spend, but that assumption is not just wrong, it is demonstrably wrong, and it's expensive, and it's been ruinously wrong.

Getting this wrong shows how important it is to understand modern monetary theory, because it helps get things right.

And that's partly because government borrowing costs are so much lower than those of the private sector. We can compare 5% at present with 15% for PFI. There is no sense in paying 15% when the government, even if it were borrowing, would pay 5%. And in practice, the reason why the government can pay such a low rate is that everybody knows the government can repay, and it doesn't actually borrow as a consequence, but it does take deposits.

So the point is, that PFI is massively excessively expensive. There is no way to justify these costs, especially when modern monetary theory shows that this is completely unnecessary. But Rachel Reeves has boxed herself in with fiscal rules that treat all borrowing as equally bad. There's no distinction in her rules in effect between borrowing for investment and borrowing to spend, which is absurd. Any accountant can tell you there's a difference, and instead, she's looking at what are called off-balance sheet solutions. That is a pretence that the borrowing that exists is not really there because it doesn't have to be accounted for as if the government owes it at present. That is exactly what Gordon Brown did when he basically absorbed PFI into Labour Party policy, and that's exactly what Rachel Reeves will do now.

She is talking about using PFI as if it is about fiscal responsibility, when actually it is fiscal illiteracy dressed up as prudence; when it is the absolute opposite of that, it is pure recklessness.

PFI was tried for three decades, and every serious review of it found it offered poor value for money. The National Audit Office, the Public Accounts Committee, the House of Commons Treasury Committee, all of them condemned it without qualification. The estimated cost over public borrowing has now been estimated at at least £200 billion.

If new towns are funded in this way, their residents and their new councils will be burdened with debt for generations. These places will be condemned to poverty from the start as a result. You might as well set out to build slums because that is what these places are going to feel like, because of the burden of debt hanging around their necks. That's not just bad financial planning, it's the creation of gross injustice.

Reeves must reform her fiscal rules to allow direct public investment if she wants to build new towns. That is the point. She could fund them at public borrowing rates. The cost of getting this wrong will fall on the very communities these towns are meant to serve.

She's failing, she's failing us. She's failing the people she wants to relocate to these new towns. She's condemning them to a miserable future from the outset, and all of this because she wants to take finance off her balance sheet. This is the worst form of financial engineering you can imagine because it has a massive human cost.

That's what I think. What do you think? There's a poll down below. Please let us have your opinions. Please like this video if that's what you do, and please share it because that helps us with YouTube. And if you are interested in buying Tom over there a coffee, or me one as well, then we'd be very grateful because they help us to fund future videos of this sort.

Poll

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