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The Private Finance Initiative (PFI)

The PFI is one of a range of government policies designed to increase private sector involvement in the provision of public services. This paper looks at the origins of the PFI, expenditure on PFI projects and discusses the arguments for and against the PFI by looking at some of the current topics of interest.

Grahame Allen

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Summary of main points

The Private Finance Initiative (PFI) was announced in the 1992 Autumn Statement with the aim of achieving closer partnerships between the public and private sectors. It was one of a range of policies introduced by the Conservative Government to increase the involvement of the private sector in the provision of public services. Following two reviews of the PFI by Sir Malcolm Bates, the present Government has continued to pursue the delivery of some public services through this means.

PFI entails transferring the risks associated with public service projects to the private sector in part or in full. Where a private sector contractor is judged best able to deal with risk, such as construction risk, then these responsibilities should be transferred to the private sector contractor. Where the private sector is deemed less able to manage the project's risks, such as whether demand will be high enough, then at least some of the responsibility must remain within the public sector.

The PFI has meant that more capital projects have been undertaken for a given level of public expenditure and public service capital projects have been brought on stream earlier. As at 1 September 2001 there had been almost 450 PFI deals signed with a total capital value of £20 billion. The increased level of activity must be paid for by higher public expenditure in the future, as the stream of payments to the private sector grows. PFI projects signed to date have committed the Government to a stream of revenue payments to private sector contractors between 2000/01 and 2025/26 of almost £100 billion.

This paper also considers whether the PFI offers value for money, using examples of specific PFI projects where possible. However, due to the long length of some PFI contracts it will be a number of years before a complete analysis is possible.

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I What is the Private Finance Initiative (PFI)?

The Private Finance Initiative (PFI) was announced by the then Chancellor, Norman Lamont, in the 1992 Autumn Statement with the aim of increasing the involvement of the private sector in the provision of public services. The PFI is a form of public private partnership (PPP) that marries a public procurement programme, where the public sector purchases capital items from the private sector, to an extension of contracting-out, where public services are contracted from the private sector. PFI differs from privatisation in that the public sector retains a substantial role in PFI projects, either as the main purchaser of services or as an essential enabler of the project. It differs from contracting out in that the private sector provides the capital asset as well as the services. The PFI differs from other PPPs in that the private sector contractor also arranges finance for the project.

Under the most common form of PFI, the private sector designs, builds, finances and operates (DBFO) facilities based on 'output' specifications decided by public sector managers and their departments.[1] Such projects need to achieve a genuine transfer of risk to the private sector contractor to secure value for money in the use of public resources before they will be agreed. The private sector already builds most public facilities but the PFI also enables the design, financing and operation of public services to be carried out by the private sector. Under the PFI, the public sector does not own an asset, such as a hospital or school but pays the PFI contractor a stream of committed revenue payments for the use of the facilities over the contract period. Once the contract has expired, ownership of the asset either remains with the private sector contractor, or is returned to the public sector, depending on the terms of the original contract.

A. The scope of PFI projects

Table 1 shows that by 1 September 2001 there had been almost 450 PFI project contracts signed with a total value of just over £20 billion, 40% of which has been accounted for by the Department of Transport, Local Government and the Regions (DTLR). The Department of Health has signed the most PFI deals, 105, with a total value of just over £2.5 billion. The largest of these, in monetary terms, is the University College London Hospitals NHS Trust PFI project. The £404 million project includes a development in Euston Road, London to house the University College Hospitals (UCHs), the Middlesex Hospital and the Hospital for Tropical Diseases all on one site.[2]

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[1] For reference, a step by step guide to the PFI process appears in Appendix 1 of this Paper.

[2] Jo Revill, "A Patient's Dream Hospital, But Figures May Not Add Up", *The Evening Standard*, 1 September 1999, p17.

Table 1: PFI signed deals by department, as at 1 September 2001

	Number	£ million
Transport, Local Government and the Regions	58	8,289
Health	105	2,502
Defence	37	1,868
Scotland	56	1,865
Home Office	39	1,379
Education and Skills	69	1,167
Work and Pensions	7	835
Inland Revenue[a]	8	391
GCHQ	1	330
Wales	11	309
Environment, Food and Rural Affairs	8	249
Lord Chancellor's Departments	7	208
Trade and Industry	8	185
Northern Ireland	22	130
Treasury	1	118
Customs & Excise	1	73
Foreign and Commonwealth Office	4	62
Northern Ireland Court Service	2	58
Office of Government Commerce	1	10
Culture, Media and Sport	3	7
Public Record Office	1	-
Total[a]	449	20,033

Note: [a] Excludes NIRS 2

Source: Office of Government Commerce

PFI deals have ranged from small projects, such as the £100,000 Littlehampton Community School ITC facilities project in West Sussex, to Europe's largest construction project; the £4 billion deal for the Channel Tunnel Rail Link (CTRL). Table 2 shows the 15 largest PFI deals, in value terms, as at 1 September 2001.

Table 2: PFI projects (signed deals) over £200 million, as at 1 September 2001

	Department	Year signed	£ million
Channel Tunnel Rail Link	DTLR	2000	4,178
PRIME (Accommodation transfer to the private sector)	DWP	1995	665
Public Safety Radio Communication Project (PSRCP)	HO	1995	500
Birmingham N. Relief Road	DTLR	2000	450
Northern Line Trains	DTLR	1995	409
University College London Hospitals NHST	DoH	1995	404
Main Building Redevelopment Headquarters	MoD	2000	400
London Underground Connect	DTLR	2000	355
Second Severn Crossing	DTLR	1995	331
GCHQ Building	FCO	2000	330
Armed Forces Personnel Administration Agency (AFPAA)	MoD	2000	264
Project 2002 (Glasgow Schools Project) (29 schools)	Scotland	1995	225
M1/A1 Link Road	DTLR	2000	214
Croydon Tramlink	DTLR	2000	205
DLR Extension - Lewisham link	DTLR	2000	202

Source: Office of Government Commerce

A full list of all signed deals as at 1 September 2001 can be found at the Office of Government Commerce (OGC) web site.[3]

B. Types of PFI projects

Under the PFI three broad types of projects can be identified: free-standing projects, joint ventures and services sold to the public sector:[4]

1. Free-standing projects

The private sector undertakes a project on the basis that costs will be recovered entirely through a charge for the services to the final user, for example the Queen Elizabeth II (Dartford) Bridge. The Government may contribute value to the project in terms of initial planning and statutory procedures, or determining the route of a linking road, etc. When the private sector is wholly responsible for a project needing Government approval, and can recoup costs through charges at the point of use, it is not necessary to compare the project with a public sector comparator (PSC). Assuming the usual planning and other necessary permissions have been obtained, the scheme can go ahead.

2. Joint ventures

Joint ventures are projects to which both the public and private sectors contribute, but where the private sector has overall control. In many cases, the public sector contribution is made to secure wider social benefits, such as road decongestion resulting from an estuarial crossing. In other cases Government may benefit through obtaining services not available within the time scale required. The project as a whole must make economic sense and competing uses of the resources must be considered. The main requirements for joint venture projects are:

- private sector partners in a joint venture should be chosen through competition;
- control of the joint venture should rest with the private sector;
- the Government's contribution should be clearly defined and limited. After taking this into account, costs will need to be recouped from users or customers; and
- the allocation of risk and reward will need to be clearly defined and agreed in advance, with private sector returns genuinely subject to risk.

The Government's contribution can take a number of forms, such as concessionary loans, equity, transfer of existing assets, ancillary or associated works, or some combination of these. If there is a Government equity stake, it will not be a controlling one. The Government may also contribute in terms of initial planning regulations or straight grant-subsidies.

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[3] OGC web site as at 13 December 2001: www.ogc.gov.uk
[4] HM Treasury, *Breaking New Ground*, November 1993

3. Services sold to the public sector

These are services provided by the private sector to the public sector, often where a significant part of the cost is capital expenditure. For example:

- a private sector firm selling kidney dialysis services to a hospital;
- the private sector providing accommodation and day-to-day care for the elderly; or
- the provision of prison places by the private sector through designing, building, financing and operating new prisons.

The public sector purchaser needs to be assured that the value for money of obtaining services in this way is better than the alternatives. Contractual arrangements must be on a commercial basis and not involve the public sector in underwriting the asset's use by other customers.

II The Origins of the Private Finance Initiative

Prior to 1989, governments were not keen to allow private capital in the financing of public sector projects. Their position was set out in the so-called *Ryrie-Rules*. The Rules presupposed that some projects, such as road building, should be undertaken by the public sector and that, where private sector finance was involved, public expenditure cover would usually be required.

A. The Ryrie Rules

The Ryrie Rules were formulated by a National Economic Development Council (NEDC) working party in 1981 under the chairmanship of Sir William Ryrie, then Second Permanent Secretary to the Treasury. The Rules sort to establish criteria under which private finance could be introduced into the nationalised industries. The Ryrie Rules said that:

> (i) decisions to provide funds for investment should be taken under conditions of fair competition with private sector borrowers; any links with the rest of the public sector, Government guarantees or commitments, or monopoly power should not result in the schemes offering investors a degree of security significantly greater than that available on private sector projects;
>
> (ii) such projects should yield benefits in terms of improved efficiency and profit from the additional investment commensurate with the cost of raising risk capital from financial markets.[5]

The Rules were revised in February 1988 to take account of the privatisation of the previously nationalised industries and the introduction of schemes such as contracting out,

[5] House of Commons Library Deposited Paper 3639.

opting out, mixed funding and partnership schemes. The two fundamental principles of the guidelines were:

- private finance could only be introduced where it offered cost effectiveness; and
- privately financed projects for public sector programmes had to be taken into account by the Government in its public expenditure planning (ie such projects had to have public expenditure cover).

In a speech to the Institute of Directors in May 1989, John Major, then Chief Secretary to the Treasury, formally retired the Ryrie Rules on the grounds that they had outlived their usefulness.[6] The retirement was intended to further encourage "the private sector to bring forward schemes for privately financed roads, which offer value for money for the user and the taxpayer". In the same speech Mr Major gave an "explicit assurance" that he "would not seek reductions in the [public] road programme on a scheme by scheme basis to offset privately financed projects".

B. The Private Finance Initiative (PFI)

The Ryrie Rules were superseded by the Private Finance Initiative (PFI) announced by Norman Lamont, in his 1992 Autumn Statement:

> I said in my Mansion House speech that I was examining ways to increase the scope for private financing of capital projects. Obviously, the interests of the taxpayer have to be protected, but I also want to ensure that sensible investment decisions are taken whenever the opportunity arises. I am now able to announce three significant developments.
>
> In the past, the Government have been prepared to give the go-ahead to private projects only after comparing them with a similar project in the public sector. This has applied, whether or not there was any prospect of the project ever being carried out in the public sector. I have decided to scrap this rule. In future, any privately financed project which can be operated profitably will be allowed to proceed. […] Secondly, the Government have too often in the past treated proposed projects as either wholly private or wholly public. In future, the Government will actively encourage joint ventures with the private sector, where these involve a sensible transfer of risk to the private sector. […]
>
> Thirdly, we will allow greater use of leasing where it offers good value for money. As long as it can be shown that the risk stays with the private sector, public organisations will be able to enter into operating lease agreements, with only the lease payments counting as expenditure and without their capital budgets being cut.[7]

[6] HM Treasury, *Private Finance for Roads*, News release 41/89, 5 May 1989.
[7] HC Deb 12 November 1992 vol 213 c998

The aim of introducing the PFI was to achieve closer partnerships between the public and private sectors at both central government and local authority levels. The guiding principles of the PFI are similar to those underlying the Ryrie Rules: ventures established under the PFI need to achieve a genuine transfer of risk to the private sector and secure value for money in the use of public resources. The new policy had a limited impact in the early months and, when he became Chancellor, Kenneth Clarke decided it needed further impetus. In autumn 1993, he announced the creation of a Private Finance Panel (PFP) whose role was:

- to encourage the greater participation in the initiative by both public and private sectors;
- to stimulate new ideas;
- to identify new areas of public sector activity where the private sector could get involved; and
- to seek solutions to any problems that might impede progress.

In a speech to the CBI Conference on 8 November 1994 Mr Clarke reiterated the two guiding principles of the PFI:[8]

- the private sector must genuinely assume risk without the guarantee by the taxpayer against loss; and
- value for money must be demonstrated for any expenditure by the public sector.

The Chancellor told the CBI conference that “private sector finance would be the main source of growth” in public investment projects and that the Treasury would not approve capital projects unless private finance options had been explored. Mr Clarke also stressed that for projects conducted under the PFI no target rates of return or profit caps existed or would be introduced. He made it clear that he wanted to maximise the scope for and use of private finance, reserving public capital provision for those areas where private finance was considered inappropriate or could not be expected to provide value for money.

In the 1995 Budget, the Chancellor announced another re-launch of the PFI and a £9.4 billion list of “priority” projects.[9] Michael Jack, then Financial Secretary, sought to allay widespread scepticism as to the ability of the government to proceed with PFI contracts and the readiness of the private sector to participate. He published a new PFI handbook, *Private Opportunity Public Benefit, progressing the Private Finance Initiative*[10] drawing together the lessons that had been learnt from some key PFI projects. He also pledged to eliminate “unnecessary bureaucracy” and to promote a more favourable climate for the initiative across Whitehall.

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8 HM Treasury, *Private Finance: Overview of progress*, News release 118/94, 8 November 1994

9 HM Treasury, *Financial Statement and Budget Report*, HC 30 1995/96, November 1995

10 HM Treasury/PFP, *Private Opportunity Public Benefit, progressing the Private Finance Initiative*, November 1995.

C. Changes introduced by the Labour Government

On 8 May 1997, Geoffrey Robinson, then Paymaster General, announced that Malcolm Bates, Chairman of Pearl Group and Premier Farnell, would conduct a speedy review of the PFI process. Mr Robinson also announced the end to universal testing - the rule that all capital projects had to be tested for private finance potential.[11] This first 'Bates review' reported on 26 June 1997 and made 27 recommendations to the Government to streamline and improve delivery of PFI projects.[12] One consequence was the creation of a PFI Taskforce inside the Treasury, drawn from the City, to help foster PFI expertise in government.

1. Treasury Taskforce

The Treasury Taskforce, set up in September 1997, was to be the central focal point for all PFI activities across government. The Taskforce focused on a number of significant projects, helping departments to set priorities from the outset while trying to ease negotiations and to get value for money. The Government published, through the Taskforce, a series of guidance documents, policy statements, technical notes and case studies. These are now available on the web site of the Office of Government Commerce (OGC).[13] *Partnerships for Prosperity* was published on 4 November 1997 to report on progress in meeting the further recommendations contained in the Bates review. The document set out the Government's support for PFI, the role of the Treasury Private Finance Taskforce, fundamental PFI policy principles, the procurement process and a list of key contacts and further reference areas.[14]

2. Partnerships UK[15]

A second review of the PFI by Sir Malcolm Bates was published in July 1999.[16] Among other things, Sir Malcolm recommended that a permanent organisation, Partnerships UK, be formed to replace the Taskforce, whose two-year life was drawing to a close:

> The ground breaking Partnerships UK will itself be formed as a partnership, with the private sector taking a majority stake in a joint venture with central government and with a Board Chairman drawn from the private sector. Public sector bodies thinking of entering into PFI deals will be able to use Partnerships

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[11] HM Treasury, *Paymaster General announces kick-start to PFI (Public/Private partnerships) - Review of Private Finance Machinery - End of Universal Testing*, News release 41/97, 8 May 1997

[12] HM Treasury, *Robinson re-invigorates the PFI*, News release 69/97, 23 June 1997

[13] Office of Government Commerce web site as at 13 December 2001: www.ogc.gov.uk/pfi/

[14] HM Treasury, *Partnerships for prosperity - a new framework for the PFI*, News release 132/97, 4 November 1997

[15] More information on the role and structure of Partnerships UK can be found on their web site: www.partnershipsuk.org.uk.

[16] House of Commons Library Deposited Paper 99/1433

> UK on a voluntary basis. It will have no monopoly and will seek to win business on the strength of its expertise.[17]

Partnerships UK, launched in June 2000, replaced the projects arm of the Treasury Taskforce, provision for which was made by the *Government Resources and Accounts Act 2000*.[18] Partnerships UK works both with public and private bodies on specific PPP transactions to improve the process of planning, negotiating and completing PPPs. Its board comprises members from both the private and public sectors. The public's interest is represented through an advisory council, consisting of the main public sector stakeholders in Partnerships UK, such as Peter Gershon, Chief Executive of the OGC.[19] In March 2001, Partnerships UK became a public private partnership (PPP) in its own right following the sale to private investors of a 51% stake, the remaining 49% being retained by the public sector. Alan Milburn, then Chief Secretary to the Treasury, said this "would provide the public sector with the key commercial skills to forge increased and better partnerships with the private sector on equal terms."[20]

3. The Office of Government Commerce (OGC)[21]

The creation of the Office of Government Commerce (OGC) was announced in July 1999, following a review of procurement in central government by Peter Gershon.[22] The OGC was established in April 2000, replacing the policy arm of the Treasury Taskforce. Its stated aim is to modernise procurement throughout government. OGC also represents the UK on procurement matters in Europe, at the World Trade Organisation (WTO) and in other international fora.

OGC reports to the Chief Secretary of the Treasury. It has a supervisory board chaired by the Chief Secretary, and made up of Permanent Secretaries, including the Chief Executive of OGC, the Head of the National Audit Office (NAO), and senior external representatives. The OGC Chief Executive has an advisory group (CEAG) comprised of representatives from a wide range of Government departments, executive agencies and non-departmental public bodies (NDPBs) whom, in the course of their duties, undertake a full range of civil government commercial activities.[23] Within OGC, the Private Finance Unit (PFU) is responsible for developing and promoting PFI policy for public bodies. It works with customers, industry and utilises the services of Partnerships UK to identify and disseminate advice on best practice.

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[17] HM Treasury, *Treasury Taskforce, Treasury, Shake-up for PFI and Government procurement plans will save up to £1 billion*, News release 124/99, 22 July 1999

[18] Partnership UK web site as at 13 December 2001: www.partnershipsuk.org.uk/puk/index.htm

[19] A full list of members of the board, the advisory council, the private sector investors and the values of Partnerships UK as at 23 October 2001, appears in Appendix 2 of this Paper.

[20] Partnerships UK, *Successful Capital Raising for Partnerships UK*, news release, 3 April 2001

[21] More information about the OGC can be found on their web site: www.ogc.gov.uk

[22] HM Treasury, *Chief Executive–Office of Government Commerce*, News release 15/00, 11 February 2000

[23] A full list of members of the supervisory board and the CEAG of the OGC, as at 23 October 2001, appears in Appendix 3 o0f this Paper.

III Public finance and the PFI

A. Has the PFI increased Public Expenditure?

Before the late 1980s, increased PFI spending occurred alongside planned falls in public sector capital spending, leading to suggestions that some public sector investment was being displaced by PFI spending.[24] By retiring the Ryrie Rules in 1989 it seemed that the Treasury was introducing an 'additionality' principle into public sector projects (funding from the private sector should be additional to public sector funding and not instead of it). The new policy was clarified further in the 1990 Green Paper *New Roads by New Means*:

> There has been much misunderstanding about additionality. Many have claimed that privately funded schemes must be additional to those funded by the Exchequer if private finance is to attract the construction industry [...].
>
> The private financing of a scheme already in the road programme, and for which public expenditure resources have been allocated, will not free that public expenditure for other projects. For these reasons the Government, in roads as in other fields (such as housing), has to take account of the provision being made by the private sector in considering the size of its public sector programme. But it is not practical - the timescales are wrong - in the great majority of cases to decide whether individual schemes are additional or not. The Government therefore gives the assurance that it will not subtract privately financed roads from public sector provision on a scheme-by-scheme basis. The Government believes that in practice private sector schemes will provide the opportunity for more roads than would otherwise have been built.[25]

The 1990 Transport Select Committee Report *Roads for the Future* commented on the additionality principle and the retirement of the Ryrie Rules:

> Additionality is a term that refers to the issue of whether attracting private sector finance will lead to an addition to the roads programme, or displace public sector expenditure, with little or no net addition.
>
> Our witnesses all welcomed the recent retirement by the Government of the Ryrie Rules. These were interpreted in such a way as to limit the conditions under which privately financed schemes would be allowed by the Treasury. In the Green Paper the Government "gives the assurance that it will not subtract privately financed roads from public sector provision on a scheme-by-scheme basis. The Government believes that in practice private sector schemes will provide the opportunity for more roads than would otherwise have been built." We welcome this clarification.

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[24] According to the 1995 Red Book, the government's net capital spending programme over the planning period 1995-96 to 1998-99 public sector capital expenditure was set to fall by £2.5 billion.

[25] Department of Transport, *New Roads by New Means,* Cm 698, 1990

> But the same paragraph creates ambiguity in the Government's position: "But the annual level of expenditure on the roads programme is determined by the Government in the light of the economy generally and the needs of that programme; a different method of financing it does not make more resources available ... The Government ... has to take account of the provision being made by the private sector in considering the size of its public sector programme." **Will private sector funding be allowed to lead to a net increase in the long run, or is the spirit of the Ryrie Rules still in evidence?**[26]

The Transport Committee's report highlighted an ambiguity in the Government's position as set out in the above extract from the Green Paper suggesting that the additionality principle would be applied only to individual schemes. For example, a contribution from the private sector to an individual transport project would not displace public sector funding for that particular transport project but might be subtracted from total public expenditure on transport.

B. Is PFI capital expenditure additional or substitutional?

According to the 2001 *Pre-Budget Report*, public sector capital expenditure is projected to rise from £19.0bn in 2000/01 to £33.2bn in 2003/04. As a proportion of GDP, public sector capital expenditure will rise from 2.0% of GDP to 3.0% over this period. It is expected that the rise in public sector capital expenditure will be supplemented by capital expenditure under the PFI, raising total publicly sponsored capital expenditure from £22.9bn in 2000/01 to £35.6bn in 2003/04. The figures are set out in table 3.

Table 3: Public sector capital expenditure
£ billion

	Outturn	Projections		
	2000/01	2001/02	2002/03	2003/04
Total public sector capital expenditure[a]	**19.0**	**26.0**	**28.8**	**33.2**
(As % of GDP)	2.0%	2.6%	2.8%	3.0%
Estimated capital expenditure under PFI	**3.9**	**3.5**	**3.1**	**2.4**
(As % of total public capital expenditure)	17.0%	11.9%	9.7%	6.7%
Total publicly sponsored capital expenditure	**22.9**	**29.5**	**31.9**	**35.6**
(As % of GDP)	2.4%	3.0%	3.0%	3.2%
Memo				
Public sector gross investment	19.0	26.0	28.8	33.2
less depreciation	-12.7	-13.2	-14.0	-14.6
Public sector net investment	6.3	12.8	14.8	18.6
(As % of GDP)	0.7%	1.3%	1.4%	1.7%
GDP	955	998	1,046	1,099

Note: [a] Net of asset sales.

Sources: Derived from HM Treasury, *Pre-Budget Report*, Cm 5318, November 2001 and *FSBR 2001*, HC 279, 2000/01

[26] Transport Select Committee, *Roads for the Future*, 1 February 1990, HC 198-I 1989-90, para 154-156.

These figures suggest that PFI capital spending may be additional to public sector capital expenditure as both public sector capital expenditure and total publicly sponsored capital expenditure are set to rise over the period. In reality it is difficult to demonstrate that something is additional to what would have happened anyway. As a first round effect, some PFI capital expenditure is clearly substitutional as some public capital spending is replaced. This was explained in evidence to the Treasury Committee during its 1996 enquiry into the PFI when an official explained the difficulty but stated that in the current spending round:

> […] there has been a deletion against previous capital plans of certain sums which the Government have planned to spend because the PFI can be seen to provide an alternative way of procuring those services.[27]

Investment through the PFI may be additional when any second round effects are taken into account. For example, public funds that are released from a department's capital programme, by an injection of PFI investment, can be used elsewhere to create additional activity. This could be additional spending compared with what would have been the case in the absence of the PFI. A second way in which PFI could provide additional spending is through efficiency savings, which again would release public funds for other purposes.

C. How are PFI projects accounted for?

If a DBFO project is financed under the PFI, the capital expenditure does not normally score as public expenditure, although the charges levied by the private sector operator for the use of the building and services that are provided do. This is because under the PFI the private sector contractor arranges the finance. This idea is better known as 'off-balance sheet' financing as the liability for the debt is not recognised on the public sector balance sheet.[28] As Philip Stephens commented in the *Financial Times* in 1996:

> The most obvious effect [of the PFI] on the public finances is to reduce spending now and replace it with a stream of future liabilities. A private contractor picks up the bill for the construction of, say, a new prison, while the taxpayer guarantees it an income spread out over the lifetime of the asset. Today's capital investment thus becomes tomorrow's current spending.

And later;

> […] We know that, like all off-balance sheet spending, the PFI flatters the official accounts. Future liabilities do not show up in the accounts.[29]

In an article critical of the PFI, the *Economist* magazine expressed concern about the scope for a government to use the PFI to disguise the underlying position of public finances. The

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[27] Treasury Committee, *The Private Finance Initiative*, 1 April 1996, HC 146 1995-96
[28] UNISON, *Public Services Private Finance*, March 2001
[29] "Buy now, pay later", *Financial Times*, 19 April 1996

Economist commented that although it was plausible that a private operator could minimise future management costs, such advantages should be:

> [...] set against the potential which the PFI offers governments for creative accounting designed to disguise their spending commitments. In particular, the timing of spending can be obscured. If a project, such as a road, is publicly financed, the construction costs are counted as public spending as they occur; if it is privately financed, they are added to public spending years later, when the road is complete and the government starts to pay the contractor for it, perhaps through a 'shadow' toll pegged to how many cars use the road. And if a project, say a toll bridge, is financed by the operator levying a charge on users, its cost will never appear in the public-spending total. The temptation is obvious. Economic commentators watch public spending and borrowing closely, not only to judge the government's own finances but as indicators of how well it is managing the economy as a whole. The PFI can lower both these numbers, at least for a time. […] Because the obligation to pay for the service or facility provided by the private investor will not be counted as public borrowing (though it will be just as binding), the borrowing figure will be lowered too.
>
> To 'prove' that the government is not using the PFI as an accounting scam, the Treasury constantly stresses that PFI projects involve genuine transfers of risk to private investors. Likewise, the private finance Panel publishes apparently detailed analyses of the efficiency gains achieved by recent projects. [...] Yet these attempts at explanation raise more questions than answers. For instance, private contractors appear to be willing to bear risks over which they have no control - in the case of the national-insurance computer, the supplier will bear much of the risk of demand volumes being lower than expected because of, say, the impact of new social-security legislation. This seems hard to swallow. Moreover, it is impossible to assess the financial impact of any risk transfer because contracts between the government and its suppliers are usually kept secret to protect commercial confidentiality. [30]

In a 1996 report, the Treasury Committee made clear its concern about the absence of any systematic recording of PFI commitments in the public accounts. Sir Christopher Bland of the Private Finance Panel (PFP), when giving evidence to the Committee, noted:

> […] the Treasury do not centrally total those forward commitments for every government department, and it is the case that not all government departments themselves total those forward commitments [...] and if you ask some departments "What are the revenue implications of the PFI contracts they have signed in the year say, 2005?", they would not readily be able to give you an answer, and if you asked the Treasury "What is the sum total of the PFI commitments in the year 2005?", they would not readily be able to give you a total, but the information is

[30] "Cooking the books", *Economist*, 28 October 1995

> there and it needs to be codified, organised and assembled fairly speedily in our view.[31]

In response to a recommendation from the Treasury Committee in 1996 the Treasury now publishes forecasts of the committed expenditure for public services flowing from private sector investments signed under the PFI. The following table from the 2001 *Financial Statement and Budget Report* (*FSBR*) set out the estimated future payments to the private sector for signed PFI deals.

Table 4: Estimated payments under PFI contracts, signed deals as at March 2001

£ million

2000-01	2,906	2013-14	3,806
2001-02	3,595	2014-15	3,676
2002-03	4,084	2015-16	3,681
2003-04	4,478	2016-17	3,680
2004-05	4,524	2017-18	3,619
2005-06	4,509	2018-19	3,059
2006-07	4,554	2019-20	3,038
2007-08	4,505	2020-21	3,149
2008-09	4,466	2021-22	3,026
2009-10	4,371	2022-23	3,024
2010-11	4,140	2023-24	2,980
2011-12	4,090	2024-25	2,994
2012-13	3,863	2025-26	2,661

Source: FSBR 2001, HC 297, Table C18

The figures represent departments' best available estimates. Actual expenditure in future years arising from deals will depend upon the payment mechanism details for each contract. However, these figures do not tell the whole story: as more PFI deals are signed the size of payments to the private sector will increase further. The Treasury also publishes capital spending by the private sector by sponsoring department. The relevant estimates for 2000/01 to 2003/04 appear in Appendix 4 of this paper.

In September 1998, the Accounting Standards Board (ASB) stated that the capital value of PFI schemes should appear on the Government's "balance sheet". However, following negotiations between the ASB and the Treasury, in June 1999 the Treasury issued a new version of their note *How to account for PFI transactions* which allowed most PFI transactions to be excluded from Government borrowing figures on the grounds that they were "operating leases", not "finance leases".[32] The guidance states that the "property risks" and "service related risks" (staffing costs) of PFI deals should be separated out. If done properly, it should be clear that property related risk has been transferred to the

[31] Treasury Committee, *The Private Finance Initiative*, 1 April 1996, HC 146 1995-96,xi, para 29.

[32] House of Commons Library Deposited Paper 99/1259

private sector, and hence should not be on the Government balance sheet. The ASB has said that the revised accounting guidance is to be kept under review and updated as necessary in the light of developments in the PFI to ensure that it remains both "useful in practice and is consistent with the ASB's application note".[33]

D. Fiscal dilemma

The PFI helps government overcome a perceived fiscal dilemma: it enables the government to increase public investment through higher capital spending while maintaining a tight fiscal stance. The 2001 *FSBR* highlights the two fiscal rules, against which the performance of fiscal policy is currently judged:

> ***the golden rule***: over the economic cycle, the Government will borrow only to invest and not to fund current spending; and
>
> ***the sustainable investment rule***: public sector net debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level. Other things equal, net debt will be maintained below 40 per cent of GDP over the economic cycle.[34]

The golden rule requires the current budget to be in balance or surplus over the cycle, allowing the Government to borrow only for capital spending, that is "borrowing is permitted to finance public investment". It ensures "fairness between generations…" in that:

> […] the Government does not pass on the costs of services consumed today to the taxpayers of the future – each generation is expected to meet the current cost of the public services from which they benefit.[35]

Under the golden rule today's taxpayer pays for public services provided today. By contrast, if current spending is financed through borrowing tomorrow's taxpayers finance it through the cost of additional capital and interest payments. The sustainable investment rule limits government borrowing to a stable and prudent level: other things equal, lower than 40% of GDP.[36] However, a briefing note from the Institute for Fiscal Studies: *The Government's fiscal rules*, points out:

> There is nothing sacrosanct about these two rules, nor are they necessarily optimal. While it is true that meeting them would mean that the public finances were kept in good shape, a failure to do so would not automatically render the

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[33] HM Treasury, *More Private Finance Initiative (PFI) deals expected as clarity of accounting standards is resolved*, News release 103/99, 24 June 1999

[34] HM Treasury, *Financial Statement and Budget Report 2001,* HC 279, 2000/01

[35] HM Treasury, *Financial Statement and Budget Report 1999,* HC 298, 1998/1999

[36] HM Treasury, *Financial Statement and Budget Report 2001,* HC 279, 2000/01

> public finances unsustainable, and meeting them does not even necessarily imply generational fairness.
>
> The government has provided no justification for a net debt target of 40 per cent of GDP – it could just as easily have chosen 38 per cent or 42 per cent. The Maastricht Treaty, for instance, allows UK gross general government debt of no more than 60 per cent of GDP, which is consistent with net public debt being considerably higher than 40 per cent of GDP. [37]

The economic rationale for the fiscal rules is that they promote economic stability by ensuring sound public finances while at the same time allowing flexibility. The fiscal rules are set over the economic cycle, allowing fiscal balances to vary between years in keeping with the cyclical position of the economy. This allows the automatic stabilisers in the economy, such as income tax receipts and unemployment payments, to operate freely, dampening the effects of fluctuations away from trend by boosting or dampening aggregate demand. The interaction of the two rules promotes capital investment while ensuring the sustainability of the public finances in the longer term.[38]

The golden rule is not broken by funding projects through the PFI, as the capital cost of the project is allocated to the private sector, and is not discussed in detail here.[39] However, it is worth noting that supporting a project using conventional methods of public funding does not break the golden rule either, as the borrowing for such a project could count as capital investment and not as funding for current spending.

As for the sustainable investment rule the present state of the public finances could remove any incentive for government to seek private sector finance through the PFI. Since the end of the last economic cycle,[40] public sector net borrowing (PSNB), the finance needed to meet current and capital spending over and above that raised in taxes, has been negative in three of the four financial years to the tune of almost £35 billion.[41] Over the same period, public sector net debt as a percentage of gross domestic product (GDP) has fallen by 11 percentage points, from 42% in 1997/98 to 31%[42] in 2000/01.[43] GDP in 2000/01 was £955 billion.[44] 9%, the unused margin up to 40% of GDP in 2000/01, is £86 billion and capital expenditure under PFI between 1997/1998 and

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37 Institute for Fiscal Studies, *The Government's fiscal rules*, Briefing Note No. 16, April 2001

38 HM Treasury, *Financial Statement and Budget Report 2001,* HC 279, 2000/01

39 For a discussion of the PFI and the golden rule see: IPPR, *The Private Finance Initiative: Saviour, Villain or Irrelevance?* Working Paper, April 2000.

40 1985-86 to 1996-97, Source: HM Treasury, *Fiscal Policy: Current And Capital Spending*, HM Treasury website as at 13 December 2001: www.hm-treasury.gov.uk/mediastore/otherfiles/530.pdf

41 National Statistics, Public sector finances October 2001, First Release, 20 November 2001

42 This suggests that the Government could have increased public spending by 9% of GDP in 2000/01, without increasing the public sector net debt above the 40% of GDP over the economic cycle so far, other things being equal.

43 National Statistics, Public sector finances October 2001, First Release, 20 November 2001

44 HM Treasury, *Pre-Budget Report*, Cm 5318, November 2001

2000/01 is estimated to have been just over £11 billion.[45] This suggests that all the PFI projects signed since the end of the last economic cycle could have been funded by public expenditure in 2000/01, without raising public sector net debt as a percentage of GDP above 40%, thereby not breaking the sustainable investment rule.

The calculations do not include the interest payments on the national debt that would have been incurred had it not fallen over the period or the reduction in payments of interest and capital by the private sector. However, even using a generous estimate of these deductions in the calculations, it is apparent the all the PFI projects that have been signed could have been funded by public sector finance without breaking either the golden rule or the sustainable investment rule.

IV Does the PFI offer value for money?

Proponents of the PFI argue that it is an improved form of public procurement that, under the right circumstances, yields efficiency savings and greater value for money for public services than projects that have traditionally been wholly dependent upon the public sector for finance and management. Under such qualifications, the PFI provides better value for money by transferring risk, achieving lower construction costs, lower operating costs and perhaps more efficient maintenance in the long term, than comparable public sector projects.

A. Competition and the costs of construction

The value of involving the private sector in providing services for the public seems to have been widely accepted by governments. Commercial organisations have been involved in building, maintaining and sometimes operating assets for the public sector for some time. Recent governments in the UK and the European Union have seen competition for public services as central to public procurement either to help guard against corruption, or the appearance of it, and as a means of securing value for money.[46]

Under EU legislation,[47] PFI contracts above a certain monetary threshold are subject to competitive tendering. For the Bridgend and Fazakerley PFI prison projects the Prison Service received 60 expressions of interest in response to their required notice of the tender in the Official Journal of the European Communities (OJEC). Of these, five were invited to submit bids, including four bidders who had overseas partners, importing knowledge of prison PFI projects from abroad.[48] For the Bridgend contract, the eventual

[45] IPPR, *The Private Finance Initiative: Saviour, Villain or Irrelevance?* Working Paper, April 2000

[46] HM Treasury, *Breaking New Ground*, November 1993

[47] Directive 92/50/EEC, Directive 93/36/EEC and Directive 93/37/EEC. Implemented in the UK by: the *Public Supply Contracts Regulations 1995, Public Services Contracts Regulations 1993* and *Public Works Regulations 1991*.

[48] NAO, *The PFI Contracts for Bridgend and Fazakerley Prisons*, HC 253 Session 1997-98, 31 October 1997

wining bid of the Securicor/Costain consortium of £266 million was over £50 million less than that of a similar public financed scheme, which involved some contracting out, of £319 million as shown by the public sector comparator (PSC).[49]

The cost to the taxpayer of a PFI contract bid is not the only consideration made by the public sector when awarding contracts. In the case of Fazakerley Prison, the contract did not go to the lowest bidder, again Securicor/Costain, but instead went to the Group4/Tarmac consortium. This was due to the Prison Service's concerns about the capability of one contractor to simultaneously undertake two prison projects using a prototype design. Although not the lowest bidder, the Group4/Tarmac consortium had come first in quality evaluations and second to Securicor/Costain in innovation assessment for both prisons.

The consortiums made further savings during the design and build phase of these PFI projects. In respect of the Fazakerley Prison estimated savings of just over £3.4 million were achieved by reducing construction and commissioning costs. Advantages for the Prison and Police Services were also created as the prison opened five months ahead of schedule allowing them to divert resources away from housing prisoners in police cells.

B. Cost overruns

The Treasury Taskforce Technical Note No 5, *How to construct a Public Sector Comparator* highlights "…some dramatic cases of public procurement going wrong in terms of both time and cost overruns".[50] Figures for the initial and final cost estimates of the highlighted projects are shown in the top half of table 6.

Table 6: Comparison of increases in public procurement and PFI project costs
£ million

	Initial cost	Final cost	Percentage increase
Public procurement			
Trident submarine shiplift and berth, Faslane	100	314	214%
Woodhill Prison	78	102	31%
Limehouse link, London	142	293	106%
PFI projects			
Norfolk and Norwich NHS Trust	90	144	60%
Greenwich Healthcare NHS Trust	35	84	140%
Benefits Agency-Computers	200	1,400	600%

Sources: Treasury Committee, *The Private Finance Initiative* , Supplementary memorandum from TUC, HC 147, 1999/2000, pp66.
Treasury Taskforce, *How to construct a Public Sector Comparator,* Technical Note No 5

[49] HOC Library, *What is a Public Sector Comparator?* 13 December 2001, available on request

[50] Treasury Taskforce, *How to construct a Public Sector Comparator*, Technical Note No 5, OGC web site as at 13 December 2001: www.ogc.gov.uk/pfi/series_3/technote5/5tech_contents.html

The figures show that the Trident submarine ship-lift and berth at Faslane in Scotland, Woodhill prison near Milton Keynes, and the Limehouse link in London overran their initial cost estimates by 214%, 31% and 106% respectively. The technical note also suggests that 'typical' overruns averaged 12% across a wide range of traditional procurement projects.[51] The technical note suggests that the reasons for these overruns were that:

> […] public sector procurement has tended to be deficient in appreciating risk and, as a result, budgets for major procurement projects have sometimes been prone to optimism bias, ie a tendency to budget for the best possible (often lowest cost and earliest completion) outcome rather than the most likely. This has led to frequent cost and time overruns. Optimism bias has also meant inaccurate prices have been used to assess options. Such biased financial (ie price) information early in the budget process can result in real economic costs resulting from inefficient allocation of resources.

PFI projects themselves are no strangers to cost overruns as we can see from the lower half of table 6. Three PFI projects, the Norfolk and Norwich NHS Trust, the Greenwich Healthcare NHS Trust and the Benefits Agency – Computers have seen the final cost of the projects rise above initial cost estimates by 60%, 140% and 600% respectively. In other words, cost overruns can and do occur under both private sector and public sector management. The CBI have suggested that:

> […] this rise in cost is largely due to the Public Sector procurers changing their minds about what should be in the contract. The implication is that the rise in costs can be attributed to the extra capital investment and services which have been added to the contract because of this change of mind or, less benignly, because uncertainty is adding to the cost of the bid. [52]

There is no indication that the specification of the traditionally procured schemes in table 6 changed between the initial estimate of cost and delivery of the project. However, in its report in 1996 the Treasury Committee made the point that:

> There is no a priori reason why public procurement should not run to time and cost. Indeed many of the assumed benefits of PFI would appear to be available to better-managed and controlled conventional procurement.[53]

The PFI should reduce the burden on the public sector from the risk of cost overruns, provided the original contract stipulates that this risk should be transferred to the private sector contractor, thereby introducing incentives to avoid such problems.

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[51] Original source: CUP, *Government Procurement -Progress Report to the Prime Minister*, 1995-96

[52] Treasury Committee, *The Private Finance Initiative*, Supplementary memorandum from TUC, HC 147 1999/2000, pp66.

[53] Treasury Committee, *The Private Finance Initiative*, HC 146 1995/1996, para 33.

C. The transfer of risk

With the PFI, as with many other types of PPPs, value for money is achieved through the transfer of risk to the private sector, which is perceived to have an advantage in handling risk. The risks that can be transferred to the private sector can be divided into two groups, *general risks* that are common all types of public/private service projects and PFI *specific risks* that are PFI public services project specific. Examples of some of the general risks that can be identified and transferred are the subject of a Library Standard Note.[54]

1. PFI specific risks

Risks come in many forms and often depend on the characteristics of a particular project. The risks involved in providing a playground for a school are sure to differ in some aspects from the risks associated with a large scale transport project. The transfer of risk differs with PFI public services contracts in that it enables the transfer of project financing risk to the private sector. Therefore, an essential condition of any PFI project is that sufficient financial risk is transferred to the private sector to secure value for money.

The main benefit of transferring financial risk to the private sector is that they are perceived to have an advantage over the public sector in handling financial risks. Most successful private sector firms have risk analysts especially in the financial sector. Public services project financing risk; the risk of delivering an economically viable financial package, can be divided into two main types, internal *disposal risk* and external *financing risks*.

Disposal risk is the risk that the expected value of surplus departmental assets, detailed for disposal in a PFI contract to fund public services, is lower than expected. Departments can reduce their exposure to this risk by transferring assets, such as redundant hospital buildings and grounds, which have, or are to become, surplus to requirement to the private sector contractor as part of the PFI contract. *External financing risk* is the risk that the private sector contractor fails to raise sufficient funding for a public services project on the market. As with any contract, the ability of the private sector contractor to secure the finance required to complete a PFI project, must be determined by the sponsoring department before the deal is signed. External financing risks are also related to *interest rate risk*, which is the risk that the interest rate will change between the time a bid is tendered and the time a contract is signed. Adverse movements in the interest rate during this time mean that the private sector contractor has to pay more to service their debt, which may reduce the attractiveness of a PFI contract.

The transfer of project financing risk generates incentives for the private sector to supply services on time and of a higher quality as they only start to receive service payments when a flow of public services actually starts, and continued payment depends on meeting specified

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[54] HOC Library, *The PFI and the transfer of risk*, December 2001, available on request.

performance criteria.[55] A further effect of transferring a project's financing risk to the private sector is that it reduces the general risks of public service projects that have been retained by the public sector. However, risk and reward go hand in hand: the higher the perceived risk that is being transferred to the private sector, the greater the risk premium that will be required by the contractor from the public sector to compensate them for their exposure. Given that some risks are difficult to quantify it is difficult to determine whether a private sector contractor, for accepting a particular risk, is charging a suitable risk premium for either party.

2. The optimal allocation of risk

Once the risks associated with a particular PFI project have been identified the next task is to share the risks between the public and private partners. The Government recognises the principle that "risk should be allocated to whoever is best able to manage it" [56], not risk transfer for its own sake. *Private opportunity, Public benefit* states that:

> As a general rule PFI schemes should always transfer to the supplier design, construction and operating risks (both cost and performance). Demand and other risks should be a matter of negotiation with the value for money impact being tested out, where appropriate, through bids on alternative risk transfer bases against minimum and conforming requirements.
>
> Risks retained by the public sector include:
>
> - the risk of a wrongly specified requirement. Where it is known that requirements cannot be specified in their entirety initially, as in some IS/IT projects, it may be possible to share with the supplier the risk of defining remaining requirements during developments and implementation. The public sector still retains the risk in respect of the initial specification;
>
> - risk of criticism. A failure of a public service, even if entirely the responsibility of a supplier, may result in criticism of the Government or local authority along with the supplier.[57]

The risks of a public services project should only be transferred to the private sector if, and to the extent that, the private sector is capable of managing such risk. In situations where the private sector is best judged able to deal with risk, such as construction risk, then the public sector should try and transfer this responsibility completely. Where the private sector is deemed less able to manage project risk, responsibility for these risks should remain within the public sector.

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[55] Treasury Taskforce, *Partnerships for prosperity*, 1997

[56] HM Treasury, *Private Opportunity, Public Benefit Progressing the Private Finance Initiative*, November 1995.

[57] ibid.

Given that some risks are difficult to quantify, such as the liabilities that would be transferred back to the public sector in the case of a collapsed DBFO hospital project, it is difficult to assess to what extent the transfer of risk can be deemed optimal. The small amount of available evidence on risk transfer available suggests, that at least in some sectors, PFI contracts have transferred to the private sector a substantial degree of responsibility for some of the risks involved in constructing, operating and maintaining public services and financing the assets that support them.[58] The National Audit Office (NAO) recently surveyed public and private partners involved in 121 PFI projects prior to 2000.[59] Over 95% of both partners agreed that the allocation of risk was either wholly or partially appropriate. However, the views of the partners varied when asked whether they believed the projects' risks had been allocated optimally. 80% of public sector partners thought the allocation of risk wholly appropriate while only 50% of the private sector partners agreed.

An efficiently designed PFI project contract should involve the optimum transfer of all types of risk. Where the financial risks of a public service project cannot be transferred to the private sector, different forms of public private partnerships (PPPs) other then the PFI should be investigated such as design, build and operate (DBO) projects. With all this in mind, the main argument put forward by proponents of the PFI, that it provides value for money through the transfer of risk, would be better defined as value for money through the 'optimal allocation of risk'.

D. Evidence of value for money

Although the NAO has started to publish a series of reports dealing with specific PFI deals, there is still relatively little detailed information available on the performance over the long term of individual PFI projects. The NAO has so far reported on the value for money aspects of a small sample of PFI projects that are of particular interest and, as such, are not representative of the full range of projects undertaken to date. For example, reports have not as yet been made by the NAO on PFI projects where problems have occurred after contracts have been signed. These include the PFI contract to collect, store and transmit passport application data for the Passport Office by Siemens Business Services, where higher then expected demand for passports led to scenes of chaos outside Passport Offices during summer 1999. The NAO has produced value for money reports on:[60]

- Skye Bridge;
- *Bridgend and Fazakerley Prisons*;
- *NIRS2 - The Replacement National Insurance Recording System*;

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[58] OGC, *DBFO - Value in roads: A case study on the first eight DBFO road contracts and their development*, OGC web site as at 13 December 2001: www.ogc.gov.uk/pfi/

[59] NAO, *Managing the relationship to secure a successful partnership in PFI projects*, HC 375 Session 2001/2002, 29 November 2001

[60] A full list of NAO Value for Money Reports on PPP/PFI is available on the NAO web site as at 13 December 2001: www.nao.gov.uk/publications/vfmsublist/vfm_ppp.htm

- *The First Four DBFO Roads*;
- *The A74(M)/M74*;
- *Dartford and Gravesham Hospital*;
- The Immigration and Nationality Directorate's Casework Programme;
- The Passport Agency's Initial Processing and IT Support System :
- *The DSS PRIME accommodation project- the transfer of the then DSS estate to the private sector;*
- *RAF non-combat vehicles*;
- Defence Fixed Telecommunications System;
- The Contributions Agency - Newcastle Estate Development;
- Defence Fixed Telecommunications System;
- British Embassy in Berlin; and
- Channel Tunnel Rail Link.

Of the fifteen projects, or groups of projects above, the seven italicised projects have been judged for value for money purposes against a public sector comparator (PSC). This enables the present value of PFI projects to be compared with the public sector alternative, allowing the likely cost savings from, or the value for money of, such PFI deals to be estimated.

It has been calculated that the total present value of the PSCs of the seven PFI projects is just over £4.6 billion compared to the total present value of the winning bidders of just over £3.7 billion.[61] This suggests that the total cost savings of these projects was 20% or £0.9 billion. If the NAO sample was representative of all PFI projects, then an estimate of the savings from the £22 billion PFI projects signed up to 1 September 2001 would be in the region of £4.4 billion. Two of the projects make a significant contribution to total savings - NIRS 2 and PRIME - accounting for almost 81% of the total savings. If the NAO sample excluding NIRS 2 and PRIME could be thought of as more typical, then the estimated savings would be 10% or £2.2 billion. A 2000 report[62] commissioned by the Treasury Taskforce found that amongst a sample of 29 PFI projects for which a PSC was available, the average saving was closer to 17%.

Over the lifetime of the Bridgend and Fazakerley Prisons PFI schemes, the NAO has estimated that combined aggregate savings of 10% will be made when compared to prisons built using public finance and operated by the private sector. More recently a report commissioned for the Treasury Taskforce on the PFI found that:

> The operational benefits of PFI will take much more time to establish. […] The long term value for money of PFI projects will depend on how well the private sector manages the risks transferred to it and on the public sector's success in

[61] Arthur Andersen and Enterprise LSE, *Value for Money Drivers in the Private Finance Initiative*, 17 January 2000

[62] ibid.

> managing the contracts over their duration, a significant proportion of which are for 25 to 30 years.

When asked about the value for money of PFI projects most public sector managers have agreed that the PFI deal they have signed provides value for money. In the recent NAO survey of public sector managers,[63] 100% perceived at the time the contract was let that the PFI option offered marginal or better value for money. None thought the value for money poor. When asked for their current perceptions 4% changed their views and thought the value for money aspect of the PFI deal was poor.

Not all parties agree that PFI projects offer value for money. Professor Allyson Pollock of University College London has suggested that the PFI has not been delivering value for money in health projects.[64] Her research shows that some schemes have escalated in both cost and scale so that greater efficiencies or levels of risk transfer have not offset the very high financing costs and the costs of private sector borrowing. There have been some cases where health authorities and the government have had to put in extra subsidies and extra services have been contracted, to bridge the gap. An example of the gap that she cites is the decision of Worcestershire Health Authorities to finance the Worcestershire Royal Infirmary through the PFI:

> […] using PFI means that increased costs of the new hospital will be met in part from the closure of 219 inpatient beds at Kidderminster Hospital without alternate provision. But since the catchment area of the new hospital will increase by 100,000 to 380,000, the population served will have almost one-third fewer acute beds under the PFI […][65]

She continues:

> The first NHS Trust to sign a PFI contract, Dartford and Gravesham, stated in its outline business case that 'at no additional cost to commissioners [the scheme] delivers vitally important strategic objectives'. But by the time West Kent Health Authority was asked to approve the full business case, a £2m-a-year contribution was required (on top of a new contribution from central government). This led to the withdrawal of funding for proposed community health service developments, some of which were required to provide services displaced by the PFI scheme.

The evidence suggests that some types of public service projects may be more suited to the PFI than others. While road and prison projects have achieved reasonable efficiency gains, projects in other sectors such as schools and hospitals have shown minimal gains. The main reason for this is that for road and prison projects, there is no partition of core and ancillary services, enabling the private sector contractor to make design and build

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[63] NAO, *Managing the relationship to secure a successful partnership in PFI projects*, HC 375 Session 2001/2002, 29 November 2001

[64] LGIU, *Public Private Partnership: Opening the public private debate*, June 2001

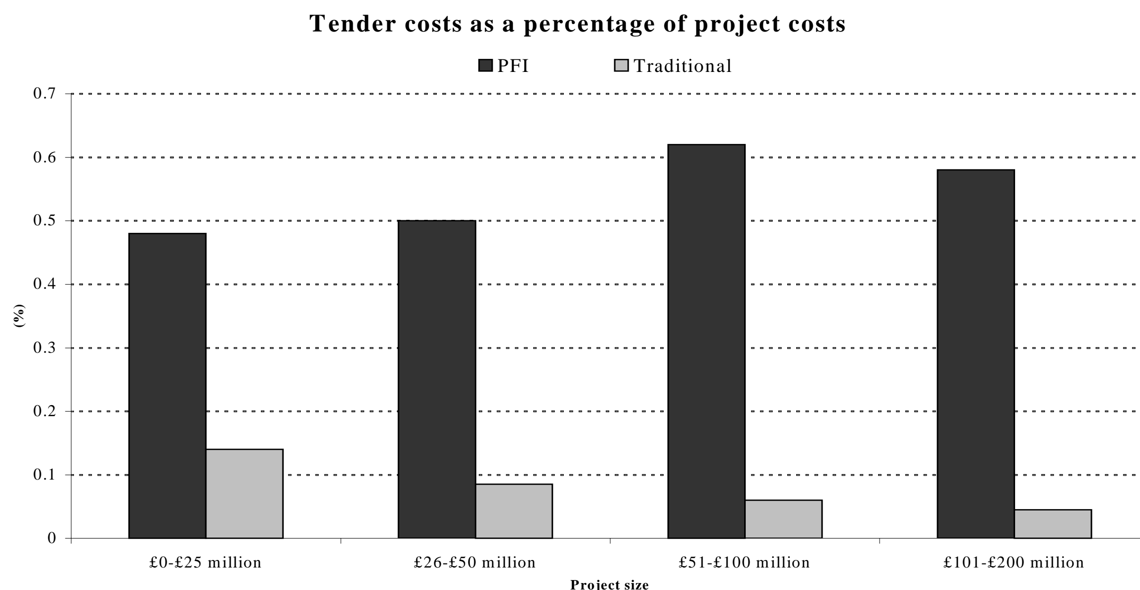
[65] Allyson Pollack, "PFI is bad for your health", *Public Finance*, 6 October 2000, pp30-31.

decisions on the basis that they will also operate the services. This does not tend to happen in health and school PFI projects where core services are still operated by the public sector. A second reason is that for road and prison schemes a single, central government agency, the Prison Service and Highways Agency respectively, is involved as the contracted purchaser, while the multi-agency dimension of hospital and school purchasers may present problems. For example, for school PFI projects it is the Local Education Authority (LEA) that sponsors a PFI scheme. However, they have to get the agreement of the school's governing body who, should the contract go ahead, have to release control of part of their budget to finance future payments to the private sector contractor.

V Current issues

A. High bidding costs

Private partners have often criticised the high cost of organising bids for PFI projects. It is argued that private sector contractors who tend for PFI project bids have to cover higher 'front-loaded' costs when drawing up detailed specifications and contract terms than when preparing bids for public services projects under conventionally tendered contracts. There is little hard evidence for the cost of the tendering process as it is usually considered confidential. The evidence that does exist appears to support the argument. A 1996 report from the Adam Smith Institute[66] found average tender costs expressed as a percentage of expected total costs, across projects of all sizes, to be higher for PFI public services projects than for traditionally procured projects, as can be seen in the figure below:[67]



[66] Dr Eamonn Butler & Allan Stewart MP, *Seize the Initiative*, Adam Smith Institute, 1996

[67] Source: Original source: BEC and Sir Michael Latham, *Constructing the team*, reproduced in Dr Eamonn Butler & Allan Stewart MP, *Seize the Initiative*, Adam Smith Institute, 1996

The report suggests that on the basis of these figures:

- PFI tendering costs are far greater than the average tender costs of other procurement methods; and this remains true no matter what the project size.
- These tendering costs are likely to be underestimated, since many of the contractors approached revealed only the cost of achieving *preferred tenderer status*. The full costs [including the contract negotiation stage] are greater – perhaps not 0.5 percent, but one percent more.
- Unlike other procurement methods, where tender costs diminish as a percentage of the total, there are no economies of scale with PFI tendering. There is instead a tendency for costs to increase as a percentage of the total.[68]

The report finds the total cost of tendering for a PFI project to all potential contractors to be just under 3% of expected total costs while for traditional procurement the total costs accounted for just under 1%.

One reason for the higher cost of tendering for PFI projects is that the time taken between offering public services projects to the private sector and the final signing of the deal can be protracted, especially for particularly intricate and technical projects. The average time taken to complete PFI deals has been estimated at 26 and 42 months for local government and NHS projects respectively.[69] There is some evidence to suggest that the relatively more expensive time spent negotiating PFI contracts with preferred bidders is longer than the time taken to initially select the bidder. If this time is not specifically included in either private or public sector cost estimates it increases total expected costs. These costs can be disproportionately high when the PFI project is small scale, such as a school's sports hall or GP's surgery.

To address these concerns, the Government has for some years been involved in consultations on establishing greater standardisation of the tendering process. On 14 July 1999 the Treasury Taskforce published new contract guidelines designed as "a platform for generating increased Private Finance Initiative (PFI) deal flow and reducing the costs of tendering".[70] The aim of the guidelines is to allow future PFI contracts across different public services to follow a consistent approach by incorporating standard conditions into all contracts. The Audit Commission has also recently produced guidance for local government managers aimed at reducing the time taken to close PFI deals:

> *If purchasers are to reduce the length of time taken to close PFI deals, they should*:
>
> - demonstrate a clear purpose and a strong vision of the desired outcomes from the scheme;

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[68] ibid.

[69] Audit Commission, *Building for the Future. The Management of Procurement Under the Private Finance Initiative*, 2001

[70] HM Treasury, *PFI standard contract guidance launched*, news release 118/99, 14 July 1999

- translate that vision into a simple output specification and resist the temptation to make regular changes to that specification;
- get early commitment to the scheme from key stakeholders;
- set up a project management structure that allows for an appropriate level of delegation to key officers and is integrated with existing decision-making processes;
- agree a clear project plan, establish project milestones and monitor progress against the plan on a regular basis;
- agree the key contractual terms, including payment mechanisms and risk transfers, prior to issuing the invitation to negotiate, in order to force bidders to indicate their position early on in the negotiation process; and
- be clear about how they are going to evaluate bids. [71]

Revised guidance on the standardisation of PFI contracts from the OGC and Partnerships UK, expected early in 2002, should also help reduce the time taken to close PFI deals, reducing bidding costs for the private sector further.

B. The cost of borrowing

Under PFI, a public sector body may gain access to private financing but the cost of such funds is unlikely to be as low as loans from the National Loans Fund (NLF). The PFI does not provide a cheaper source of finance to public sector bodies but simply provides them with another source of possible funding, probably at a higher capital cost than traditional procurement. Under present Treasury rules, public (profit-making) corporations cannot borrow and invest like private sector enterprises as their borrowing is treated as public expenditure. Comparisons of the cost of borrowing by government and the private sector are very difficult to make. The cost of borrowing at any time is determined by a variety of factors, although the main determinants are likely to be the risk of default and the expected returns.

Government borrowing through the NLF is backed by tax revenues and so is virtually risk-free and hence the cheapest way of raising funds. Private sector companies, which have no such guarantees, are inherently riskier propositions and hence borrow on less advantageous terms. City, or local authority, borrowing may be somewhere between these two, although some companies might be able to borrow money more cheaply than a public authority, especially if the authority is relatively new or has a less than perfect reputation for financial rigour.

Due to the difficulties involved in comparing the actual costs of public and private financing of PFI projects, disparities in the yields of bonds issued by public, private and public/private organisations have often been looked at as proxies. In this cost hierarchy the cheapest source of funds comes from government. Next it is suggested, would be a

[71] Audit Commission, *Building for the Future. The Management of Procurement Under the Private Finance Initiative*, 2001

government/fare revenue backed body such as London Underground. Next are large public limited companies (plcs) many of whom are PFI players. However, this does not take us very far since a plc is likely to raise capital by a cost-minimising combination of a new share issue, bank finance and commercial bonds rather than just through a bond issue alone.

The crucial aspect here is the cost differential between the alternatives and, although it is dangerous to generalise from the evidence of a few borrowers, the following figures are nevertheless helpful. According to figures in the *Financial Times*[72] the yield on 10-year government bonds at the close of play on 12 September 2001 was 4.9%. Similarly dated corporate bonds ranged between 6.9% for Gallaher and 5.6% for Halifax. This suggests that the extra borrowing cost of corporate bonds could be at least one and a half percentage point higher than government bonds. The differential between the returns on public funds and private equity is likely to be much greater. This was demonstrated in the NAO report on the Skye Bridge.[73] The NAO calculated that the extra financing cost of the Skye Bridge was some £4 million on a total project cost of £28 million, or one-seventh. The cost of (private) equity was some 18.4% in real terms, compared with the cost of public capital of 6%. In this case the private finance option required more than 12% percentage points per year above the public finance rate. The recent report by Arthur Anderson/Enterprise LSE on the PFI found that:

> The [financing costs] difference on the average PFI project is now typically in the range of only 1-3 percentage points.
>
> This gap between the cost of private sector capital and public borrowing has been narrowing as PFI matures and the public and private sectors gain in experience, and is not as high as some of the literature suggests. The additional cost is not so significant that value for money is inherently likely to be imperilled, provided the private sector is able to deliver savings in other aspects of the project. The business cases we have examined suggest these savings are deliverable…[74]

David Currie of the London Business School has challenged the proposition that private sector borrowing costs are higher, calling proponents "naïve". He has suggested that when evaluating projects:

> […] efficiency savings are the significant factor in any decision between the two options as adopting a more appropriate approach to the evaluation of the costs of a project shows that the differences between the costs of borrowing are illusory.
>
> One of the most fundamental points in using cost benefit analysis to evaluate projects is to account for their impact on *all* individuals in a community […] in

72 *Financial Times*, 13 September 2001

73 NAO, *The Skye Bridge*, HC 5 Session 1997/98, 23 May 1997

74 Arthur Andersen and Enterprise LSE, *Value for Money Drivers in the Private Finance Initiative*, 17 January 2000

> the private sector, investors carry the risk of default and are rewarded accordingly but in the private sector, taxpayers carry the risk but receive no commensurate reward. In other words, although the public sector can borrow at the risk-free rate to finance investment, this imposes a residual risk on taxpayers in much the same way as private sector investors but without a reward. Clearly the contingent liability being imposed on taxpayers is a cost that ought to be accounted for in any cost–benefit analysis. Unfortunately it is not normal practice to quantify in the public balance sheet these contingent liabilities faced by the public. Once taken into account, the true cost of borrowing is the same for the public and private sector if the underlying risk of the projects is the same.[75]

C. European Commission Procurement Directive

Under present European Commission rules for public procurement, contracts above a certain financial threshold are put out to competitive tender in the Official Journal of the European Communities (OJEC). With regard to the PFI in the UK, these rules allow Government to chose a preferred bidder from the tenders they receive on the basis that they offer the most economically advantageous bid. The preferred bidder then negotiates the detailed proposals for a specific project, with two reserve bidders also chosen in case negotiations with the preferred bidder break down before a contract is signed. Under proposals for a new European public procurement directive, the public sector will no longer be able to select a preferred bidder. At least three bidders will be required to continue negotiations until the finalised PFI contract is signed.

The debate on public procurement rules in the EU was facilitated by the European Commission Green Paper entitled *Public Procurement in the European Union. Exploring the Way Forward*.[76] After consideration of the responses to the Green Paper, the Commission published its plans for future action in the Communication *Public Procurement in the European Union*.[77] The main theme to emerge from the Green Paper was "the need to simplify the legal framework and adapt it to the new electronic age while maintaining the stability of its basic structure"[78] in order to create a genuine single European market.

The proposed Directive[79] on the co-ordination of procedures for the award of public supply contracts,[80] public service contracts[81] and public works contracts[82] aims to consolidate the three existing Directives. With respect to the selection of tenderers for

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75 David Currie, *Funding the London Underground*, London Business School, March 2000
76 Com(96)583 final, 27 November 1996
77 Com(98) 143 final, 11 March 1998
78 ibid.
79 COM(2000)275 final
80 Implemented in the UK by: The Public Supply Contracts Regulations, SI 1995/201
81 Implemented in the UK by: The Public Services Contracts Regulations, SI 1993/3228
82 Implemented in the UK by: The Public Works Contracts Regulations, SI 1991/2680

PFI projects, the proposals strengthen the legal framework in two respects. The first strengthens the legal framework for "combating organised crime, corruption and fraud" while the second "introduces an obligation, in restricted and negotiated procedures, to apply objective criteria announced in advance so as not to limit the number of candidates invited to tender".[83] It is the second of these proposals that has caused the most worry amongst those involved with the PFI.

Article 45 of the proposed Directive (consolidating Article 27 of Directive 92/50/EEC, Article 19 of Directive 93/36/EEC and Article 22 of Directive 93/37/EEC) proposes that:

> Where contracting authorities award a contract by restricted procedure and by negotiated procedure with publication of a contract notice, namely in those cases referred to in Article 29, they may prescribe the minimum number of candidates which they intend to invite to submit a tender or negotiate. This minimum number shall be five candidates in restricted procedures and three in negotiated procedures. They may also set a maximum number of candidates which they intend to invite to submit a tender.[84]

Concern has been raised in the UK by PFI contractors and others, who are worried that public sector managers will no longer be able to select a preferred bidder to negotiate contract details on an exclusive basis if the Directive goes ahead. Instead, three bidders will be asked to produce completed schemes in an effort to reduce 'anti-competitive behaviour'. This could lead to the cost of bidding becoming prohibitive for the private sector, who are already worried about the high cost presently incurred by preferred bidders.

The chief executive of the Association of Consulting Engineers (ACE) Nicholas Bennett has said: "[the directive] may mean that firms will be unwilling to bid for PFI work, as they may have to spend £5 million or more on projects which they are ultimately not awarded."[85] In a recent article in *The Independent*[86] the Construction Confederation's European affairs director John Bromley also expressed concern "…the directive would deter many contractors from working on public sector deals. You couldn't risk losing £6m on a bid. This [he said] is a serious problem". Arthur Moore of the John Mowlem construction group said:

> This is not good news at all. If it goes through unamended we would have to completely reconfigure the PFI initiative in the UK. The PFI initiative would come to a halt… Clients and contractors would have to spend huge amounts

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83 COM(2000)275 final

84 ibid.

85 Paul Newton, "Pan-Utility Brussels' Costs a Threat to PFI", *Utility Week*, 20 July 2001

86 "Brussels Threatens to Scupper Blair's Private Finance Schemes", *The Independent*, 14 July 2001

> designing projects up front. It would move us back in procurement terms 10 years.[87]

In the same article, Robin Herzberg, chairman of the CBI Committee on European Public Procurement is quoted as saying:

> We are extremely concerned about the adverse implications of this for the PFI. It would slow the initiative down and make it far more expensive, no doubt about it at all. It would make it unworkable.

The Government commented about the consequences of the Directive for the PFI in reply to a recent WPQ in the Lords:

> **Lord Dixon-Smith asked Her Majesty's Government**: What impact the ruling by the European Commission in Brussels that "preferred bidder" status should not be awarded until a full and open tender process has been completed will have on the private finance initiative process. [HL391]
>
> **Lord McIntosh of Haringey**: The Commission has not made a "ruling" in this respect but has made proposals for revising the EC public procurement directives. The proposals are the subject of continuing discussions in the Council and the European Parliament and the Government are optimistic that the final version will make express provision for best practice in the award of PFI and other major contracts.[88]

The exact timetable of the new public procurement directive is as yet unknown. However, there appears to be a general expectation amongst the press and the construction industries that the directive will become law by 2003. The EU Parliament Committee on Legal Affairs and the Internal Market adopted the Commission's report on the directive at first reading on 16 October 2001. The report was scheduled for debate at the November 2001 plenary session in Strasbourg.[89] However, the Internal Market Council has failed to reach agreement on the draft proposals on time. The committee will now report to the parliament in plenary session later in 2002.

D. Refinancing of PFI contracts

Critics of the value for money arguments for the PFI have recently highlighted the perceived loss to the public purse from public managers failing to negotiate clauses in the original contracts, where the public sector client receives money back if the contractor subsequently refinances their borrowing.

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87 ibid.
88 HL Deb 24 July 2001 c197WA
89 Europarl News Release, 17 October 2001 available from their web site as at 13 December 2001: www.europarl.eu.int

1. Treasury guidance on refinancing

Guidance on the Standardisation of PFI Contracts[90] published in 1999 highlighted the need for public sector managers to make provision to protect a department's interest should the private sector seek to benefit from opportunities to refinance projects. However, departments do not need to have an explicit sharing mechanism or rights in a PFI contract to seek to negotiate a share of such benefits. General approval rights over changes in contracts or financing arrangements, such as termination liabilities, should put departments in a strong negotiating position.

Recent revised guidance from the Office of Government Commerce (OGC) to the public sector has stated that:

> It is implicit in PFI that contractors should benefit from effective management of projects. But departments must be alert to the very significant increase in rates of return to shareholders which refinancing may provide.
>
> The decision as to what form of refinancing may be acceptable to a department and what portion of the refinancing gain it is reasonable for the public sector to enjoy are complex. Departments are therefore strongly advised to seek appropriate specialist advice before entering discussion with contractors. If they are in any doubt they should consult the Office of Government Commerce. [91]

The scope for substantial refinancing benefits is likely to arise from early PFI deals when the PFI market was less mature than today. OGC's advice about refinancing is that:

> […] consistent with the existing guidance, in considering any refinancing proposals that are put to them, and where the contract does not state otherwise, departments should seek an equitable outcome which will protect the interests of the taxpayer and be defensible publicly. However, it is for Accounting Officers to make decisions on their own department's projects.
>
> In practice, this means that where a department's consent is required to a refinancing proposal (and where the contract does not cover the terms of that consent) before giving its consent, the department should stipulate that it be compensated for any increased risks or liabilities it might be exposed to and should also seek to share the relevant benefits on a 50/50 basis with the private sector partner.

OGC has also realised that in certain cases departments may become aware of refinancing which contractors are implementing which does not require their approval and for which they do not have explicit sharing rights. In such cases OGC guidance suggests that:

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[90] OGC, *Guidance on the Standardisation of PFI Contracts*, 1999

[91] OGC, *Guidance for Government Departments: Refinancing of PFI projects*, available on the OGC web site as at 13 December 2001: www.ogc.gov.uk/ogc/procurement.nsf/pages/Refinanc170049.html

> […] they [the public sector client] should seek to ensure with the contractor that such benefits reflect reward for management of risk and costs rather than pure windfall gain.

PFI public services projects where refinancing has occurred include the £32 million Kilmarnock Prison project[92] and the £88 million Fazakerley Prison project.

2. Fazakerley Prison scheme

Fazakerley Prison Services Limited (FPSL), the PFI project consortium formed by Group4 and Tarmac, refinanced the public services project it had been awarded by the Prison Service to design, build, finance and operate Fazakerley Prison, in November 1999.[93]

FPSL was able to refinance the project due to its success in delivering the project four months ahead of time, establishing a track record in its operation, and because of increased confidence in the financial markets towards PFI projects generally. The refinancing of the project improved the expected returns to FPSL's shareholders, both through the early repayment of their original investment and the expectation that the flow of dividends would be higher than projected. In total, the expected returns to FPSL's shareholders were increased by £10.7 million (61%) as a result of the refinancing of the project, when compared to their originally projected level, of £17.5 million, at the time the contract was signed.

The Prison Service did not consider that FPSL would be able to refinance the project and had therefore not negotiated, as part of its contractual rights, a share in any benefits from refinancing. However, the lenders to FPSL considered it prudent for Prison Service consent to be obtained, as the refinancing proposals would create additional liabilities for the Service. The Service decided that it should be compensated for agreeing to accept these additional liabilities and negotiated an up front payment from FPSL of £1 million, or 10% of the gains from refinancing. This sum was consistent with the Prison Service's estimate of the extra financial risk it was taking on.

The Prison Service acknowledged that the success of the project contributed to the opportunity for a refinancing to take place and that it was therefore reasonable for FPSL to benefit from the refinancing as a reward for taking risks in successfully developing the first PFI prison project. The Service also did not wish to deter FPSL or other consortia from bidding in future PFI prison competitions by removing opportunities for them to benefit from this type of project.

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[92] HC Deb 27 July 2000 c874W

[93] NAO, *The refinancing of the Fazakerley PFI*, HC 584 Session 1999-2000, 29 June 2000

3. Further refinancing of PFI projects

A recent article in *The Observer* attacked refinancing as 'robbery of the public' by the private sector.[94] The article detailed some PFI projects where the authors believed refinancing deals were "currently being worked on" which included:

- The £133m, 423-bed new Dartford & Gravesham hospital in Kent, developed by Carillion, United Medical Enterprises and Innisfree, a specialist PFI investment fund. Sources say PWC has been appointed to lead the deal, and that the windfall gain is likely to be around £20m. The gain is made on reducing the margin on the senior debt, worth £108m, and gearing up the financing structure by reducing the 'cushion' of second-tier debt and equity. There is no provision for a public sector clawback.

- A similar process is said to be under way at another hospital, the £67.5m, 424-bed Hairmyres in East Kilbride, being run by contractor Kier and Innisfree.

- The Bridgend prison project in South Wales will see WS Atkins, Securicor and construction giant Skanska scoop close to £5m by refinancing a £77.5m loan at a 4 per cent cheaper rate.

- Five prisons run by Premier Prison Services - a joint venture between controversial US security giant Wackenhut and facilities management outfit Serco - is thought to have yielded a £7m windfall by bundling together separate loans totalling £185m.

- The £241m scheme to redevelop an 11-building estate owned by the Inland Revenue in Newcastle stands to make millions for the consortium involved, which includes Amec and Interserve. The main debt - £168m loan arranged by Royal Bank of Scotland - is being refinanced, and the increased returns are being spread over the life of the contract.

- Road projects are also involved. Investment banker ABN Amro is organising refinancing of the pounds 268m link road between the A1 and M1 near Leeds, Yorkshire. The 18.5-year term of the loan is likely to remain, but the margin is likely to be reduced from between 130 to 140 basis points (1.3-1.4 per cent) to 85. A similar deal was completed earlier this year on the A19 road, built by the Autolink consortium. Here the Highways Agency negotiated a 30 per cent clawback of the gain for taxpayers.

- In the schools sector, Jarvis has refinanced the 1,060-place Colfox secondary school in Dorset in 1999, and the Barnhill School in Hillingdon, west London.

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[94] Oliver Morgan and Nick Mathiason, "PFI's bounty hunters: Firms developing schools and prisons pocket millions as the 'risk' factor dwindles", *The Observer*, 8 July 2001

The NAO has suggested that the further refinancing of PFI projects is likely to occur in the future to the benefit of shareholders. They have suggested that:

> There can be important consequences for departments arising from refinancings, and departments should consider what provisions they should make to share in some of the financial gains and whether their consent should be required before a refinancing can proceed.[95]

OGC has commissioned Partnerships UK to draft new guidance on the refinancing of PFI projects that will more comprehensively protect the public interest. At present, the draft revised general guidance on the standardisation of PFI contracts has been circulated to departments for public sector consultation. Once Partnerships UK has considered the public sector's comments, a revised draft will go out for private sector consultation. A final version of the document is likely to be ready for publication early in 2002.

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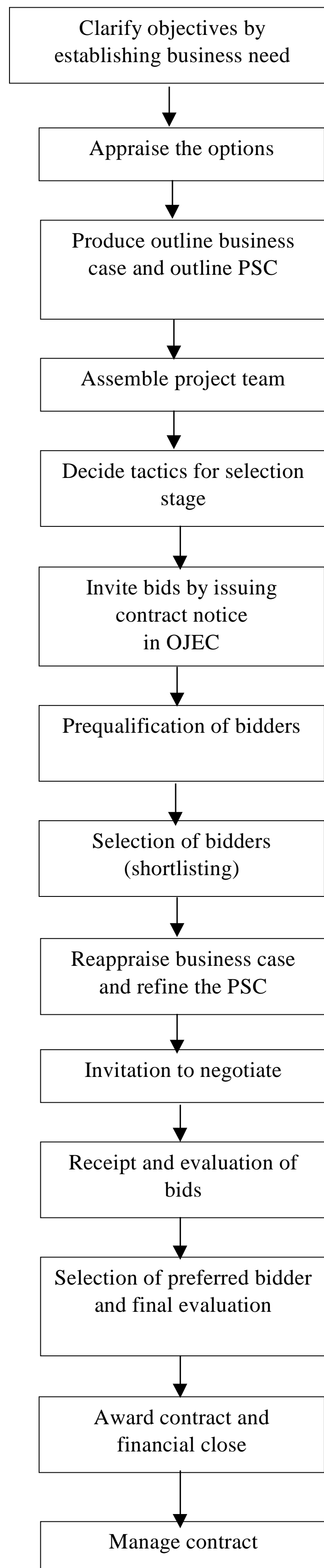
[95] NAO, The refinancing of the Fazakerley PFI, HC 584 Session 1999-2000, 29 June 2000

Appendix 1 A Step by Step Guide to the PFI Process



Source: Based on Treasury Taskforce, *Step by Step Guide to the PFI procurement Process*, November 1999

Appendix 2 Partnerships UK

Members of the Board

Executive Directors

Chief Executive	James Stewart
Head of PPPs	Michael Gerrard

Non-Executive Directors

Chairman	Derek Higgs	
Deputy Chairman	Adrian Montague	
	Jon Cunliffe	(Treasury Nominee)
	Sir Steve Robson	(Treasury Nominee)
	Gren Folwell	
	Judith Hanratty	
	Tim Stevenson	

Members of the PUK Advisory Council

Government Departments

Sir Andrew Turnbull	Chairman
Sir Richard Mottram	DTLR
Richard Douglas	Department of Health
Ken Beeton	Department for Education and Skills
Colin Balmer	Ministry of Defence
John Yard	Inland Revenue
Les Haugh	Home Office

Devolved Administrations

John Henderson	Scottish Executive
David Richards	National Assembly for Wales
Pat Carvill	Department of Finance Northern Ireland

Public Sector Stakeholders

Peter Gershon	Office of Government Commerce
Brian Briscoe	Local Government Association
Jeremy Colman	National Audit Office
Dr David Owen	Medical Research Council

Jeannie Bevan	National Savings
Dr John Bridge	One North East
Dave Fletcher	British Waterways
Jimmy Andrews	Glasgow City Council
Dr Janet Thompson	Forensic Science Service
Ken Gillespie	Kirklees Council

Partnerships UK value statement

The Government has established Partnerships UK to accelerate the development, procurement and implementation of public private partnerships. We work exclusively with and for the public sector, committing human and financial resources in pursuit of high quality, cost effective and sustainable public services and investments. Partnerships UK is as joint venture between the public and private sectors and so is itself a PPP.

Our commitment is to:

- Put the interests of our public sector clients first
- Act with integrity, fairness and transparency
- Help set best practice in developing, procuring and implementing PPPs
- Develop new models and applications for PPPs
- Deploy our human and financial resources where they provide additionality to the public sector
- Serve all parts of the public sector in delivering Government priorities
- Earn an appropriate and sustainable return on our shareholders' investments
- Invest in and develop the skills of our people to maintain Partnerships UK as a centre of expertise in PPPs

Investors in the 51% stake taken by the private sector in March 2001

AXA Investment Managers	Abbey National
Bank of Scotland	Barclays
British Land	Group 4 Falck
Halifax	Jarvis
Prudential	Royal Bank of Scotland
Serco	

Appendix 3 The Office of Government Commerce

Members of the Supervisory Board

Name	Position
Rt Hon Andrew Smith MP (Chair)	Chief Secretary to the Treasury
Brian Bender	Permanent Secretary of DEFRA
Sir John Bourn	Comptroller and Auditor General
Malcom Brinded	
General Sir Sam Cowan	Chief of Defence Logistics. Ministry of Defence
Nigel Crisp	Permanent Secretary of the Department of Health
Peter Gershon	Chief Executive of the OGC
John Gieve	Permanent Secretary of the Home Office
Martha Johnson	
Rachel Lomax	Permanent Secretary of the DWP
Nick Montagu	Chairman of the Board of the Inland Revenue
Sir Richard Mottram	Permanent Secretary of the DTLR
David Normington	Permanent Secretary of the DfEE
Sir David Omand Chairman,	Government's Centre for Management & Policy Studies
Sir Hayden Phillips	Permanent Secretary of the Lord Chancellor's Department
Andrew Pinder	E-envoy
Sir Andrew Turnbull	Permanent Secretary of the Treasury
Robin Young	Permanent Secretary of the Department of Trade and Industry

Chief Executive's Advisory Group Members

Name	Organisation	Role
Peter Gershon (Chair)	(OGC)	Chief Executive
Bryan Avery	(OGC)	Director of Strategy and Resources
Alistair Bell	(MOD)	Defence Logistics
Nick Bowd	(SE)	Procurement of Commercial Services
John Cavell	(PSA)	Head of Procurement
Stephen Clark	(CO)	Head of Infrastructure Division
Barry Cotterill	(DCMS)	Head of Procurement
Glynis Davies	(DFID)	Head of Procurement
John Dodds	(HMT)	Head of IT and Infrastructure
Julia Douch	(Wales)	Head of Procurement
Alex Fraser	(C&E)	Head of Logistics
Michael Gower	(FCO)	Purchasing
Nic Hopkins	(OGC)	Director of Customer Relations
Philippa Lloyd	(DTI)	Resource Management
Stuart Lord	(DWP)	Chief Information Officer

Colin Lyne	(LCD)	Purchasing & Contract Management
Paul Neill	(DfES)	Procurement & Contracting
David Rabey	(DEFRA)	Purchasing & Supply
Brian Rigby	(OGC)	Deputy Chief Executive
Steve Rowsell	(HA)	Procurement
Robert Scotland	(HO)	Procurement
David Smith	(IR)	Business Operations
Martin Sykes	(DTLR)	Commercial Director
Dr. Andrew Holt	(DoH)	Head Information Systems Division
Malcolm Turner	(NI-GPA)	Head of Procurement
Michael Whitehouse	(NAO)	
Mark Yeomans	(EA)	Procurement

Appendix 4 Estimates of capital spending by Department

The following table sets out estimated capital spending by the private sector, by sponsoring department,[96] for the financial years 2000/01 to 2003/04. The table shows that over the period estimated capital spending by the private sector will be just under £13bn.

Table 5: Departmental estimate of capital spending by the private sector (signed deals):
£ million

	Estimate	Projections			**Total**
	2000/01	2001/02	2002/03	2003/04	
Defence	121	147	200	100	**568**
Foreign and Commonwealth Office and International Development	7	7	6	7	**27**
Agriculture, Fisheries and Food[a]	0	0	0	0	**0**
Trade and Industry	36	61	24	26	**147**
Environment, Transport and Regions[b,c]	619	639	855	1,015	**3,128**
Education and Employment[d]	15	28	9	0	**52**
Home Office	160	136	297	0	**593**
Legal Departments	37	36	13	6	**92**
Culture, Media and Sport	0	0	0	0	**0**
Health	491	501	235	67	**1,294**
Social Security	42	17	67	14	**140**
Scotland	540	289	78	20	**927**
Wales	160	11	0	0	**171**
Northern Ireland	39	26	4	0	**69**
Chancellor's Departments	104	87	19	19	**229**
Cabinet Office	155	159	42	6	**362**
Local authorities[e,f]	1,352	1,404	1,215	1,150	**5,121**
Total	**3,878**	**3,548**	**3,064**	**2,430**	**12,920**

[a] Includes Forestry Commission

[b] Includes the private sector capital investment in Channel Tunnel Rail Link.

[c] In addition, substantial private investment is levered in through housing, urban regeneration and other programmes.

[d]Excludes private finance activity in education institutions classified to the private sector. Estimated total values for these are £80m in 2000/01 and £226m in 2001/02. Includes projects in Voluntary Aided schools only; Schools projects funded through

[e] Figures represent spending on projects supported by central government through Revenue Support Grant.

[f] PFI activity in Local Authority schools is included in the Local Authorities line.

Source: HM Treasury, FSBR 2001, HC 297, Table C16

[96] These figures were released prior to the reorganisation of Government Departments in June 2001.