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PUBLIC PRIVATE PARTNERSHIPS: THE UK DEBATE

The political dilemma

> *"We are the only Government anywhere in the Western world that this year, next year, the year after, is increasing both health and education public spending as a percentage of national income. The only one. That is our commitment to public services. We said schools and hospitals first. We're building them. Lots of them. And I am not going to go to parents and children and patients in my constituency and say, I'm sorry, because there is an argument going on about PFI we're going to put these projects on hold. They don't care who builds them. So long as they're built .... Come on: this isn't the betrayal of public services. It's their renewal"*
>
> Tony Blair's speech to Labour Party conference 1 October 2002

Tony Blair, like leaders throughout Europe, is facing the political dilemma of how to deliver better public services while maintaining fiscal prudence. The British public, proud of its welfare state, proud of its national health service, proud of the principle of a universal service free at the point of use, has in the recent past proved itself remarkably unwilling to pay for these things: For 18 years, from 1979 – 1997, it elected a tax-cutting Conservative Government with a shaky commitment to the public sector, a Government which left public services run-down and in severe need of new investment. The new Labour Government elected in 1997, which as a party in opposition had fought hard to overcome public fears about Labour's leftist tendencies, had to marry its promise to invest more in public services with strict self-imposed budgetary rules. How could this be achieved?

The answer lay with the private sector: Not in privatisation, the selling off public assets to the private sector, as the previous Conservative Government had done. Instead, Tony Blair's new Labour looked to a partnership with the private sector through a range of Public Private Partnerships (PPP), the most significant form of which is the Private Finance Initiative (PFI). To date, there have been over 500 PFI projects signed in the UK, with a value of over £22 billion, making it a significant form of investment.

But the road has not been smooth. Some difficult projects, plus questions about value for money in PFI, and a vociferous trade union campaign against 'privatisation' are causing headaches for Tony Blair's Government. How important are these problems compared to the overall opportunities offered by PPP/PFI ? Could the Labour Government have avoided any of the problems they have encountered and what are the lessons to be learned by Germany, as it too sets off down the PFI road?

Blair's battle against the strange and unholy alliance

A common criticism of 'New Labour' today is that it has drifted too far to the right in its quest for electoral dominance, that it has lost touch with its roots, and that it is no longer listening to people's concerns on key issues. The debate on public service reform is an important part of this.

This criticism of New Labour has to be seen in the light of Labour's recent history and the changes the leadership had to make in the 1980s and 1990s in order to become electable. After devastating defeats in the general elections of 1979, 1983 and 1987 it seemed that Labour had lost the ability to be popular, with a reputation for "loony left" members (most notably the far-left Militant Tendency) and out-of-touch policies (including re-nationalisation and nuclear disarmament). The leadership warned the membership that if it did not re-connect with the electorate, Labour would never win again. Winning again entailed beating the left wing within the party on important issues such as reform of Clause 4 of the party constitution (on nationalisation), the trade unions, and defence. During some painful years in opposition, the party re-made itself, dumping a lot of political baggage on the way. By 1997 Labour had come to be seen as a moderate, fiscally prudent party which was committed to greater opportunity for all and better public services. The tone of the new party was modern, open-minded, non-dogmatic; the idea of partnership with the private sector to deliver the quality public services expected by a ever-more demanding public fitted in well, and was one of the policies that symbolised the death of old Labour.

The Labour victory of 1997 was a landslide, and Tony Blair received an incredible 93% approval rate in the polls in his first few months as Prime Minister. Moreover, he sustained his popularity far longer than any other British Prime Minister has in the past 100 years. His Government is the first to be ahead of the opposition in the polls every month (except for a brief interruption during a crisis over petrol prices in September 2000), with up to 45% approval ratings, compared to a Conservative average of around 30%. Tony Blair was given the nickname 'Teflon Tony' because no dirt ever stuck to him, even when the Government had problems.

But Blair also earned the nickname 'Phoney Tony'; one of the accusations made against the Labour Government in its first years was that it was all 'spin' and no policy, and that Government policy was decided by focus groups, opinion polls and spin doctors. This cannot be said to be true any longer. Today Tony Blair is seen rather as a conviction politician, pushing forward policies he believes in without much attention to public feeling, or even to opposition within his own party. Although the Government still has a clear lead over the opposition, today this lead has as much to do with the lack of an effective parliamentary opposition as support for government policies. It has had serious problems over key issues such as policy on war with Iraq, public service reform and reform of the House of Lords. The Government's poll ratings have fallen in last few months of 2002 and the beginning of 2003 and Tony Blair's personal rating has fallen into negative territory for the first time since the petrol crisis.

Delivery of public services is one of the main problem areas in what can be politely described as a deteriorating relationship between the government and the unions. Two of the major unions representing public service workers, the GMB and Unison, are running a high profile campaign on public services, which cites all PPP/PFI as 'privatisation' and which accuses the government of "replacing the public service ethos" with the rule of markets and competition. Against this, Tony Blair insists that "creative ideas for public sector reform should not be mistaken for privatisation". In a speech to Labour's spring conference in February 2002, he branded his union critics as "small c conservatives", akin to those who had been unwilling to abandon Clause 4 or reject the far left militants in the 1980s. He urged his party to accept that it had won two election landslides by challenging political orthodoxy. He argued that it was right to provide more choice for the consumer and offer alternative providers using the private sector, so long as "it makes sense and gives value for money, and with guarantees that staff are properly treated". Labour's journey of change had been fought every inch of the way by the right and the far left – "Those attacks all through my political life actually meet at a centre point and come together in a strange and unholy alliance". The battle lines have been drawn.

What are Public Private Partnerships ?

A wide range of projects come under the heading of Public Private Partnership, and has been defined by the Government as including

- the introduction of private sector ownership into state-owned businesses with sales of either a minority or majority stake (such as the National Air Traffic Control Services – NATS - PPP)
- the Private Finance Initiative and other arrangements where the public sector contracts to purchase services on a long-term basis (such as roads, hospitals, schools and prisons)
- selling Government services into wider markets and other partnership arrangements where private sector expertise and finance are used to exploit the commercial potential of Government assets (such as the Defence Evaluation and Research Agency, which has the potential to transfer technology developed for the military into the civil sector).[1]

In volume terms, PFI is the most significant form of PPP in the UK , and most attention is focused on this area. PFI is a way of using private sector skills and finance to deliver public services, where the private partner usually Designs, Builds, Finances and Operates (DBFO) the asset (such as schools, hospital and roads) based on output specifications decided by public sector managers and their departments. 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. Sometimes the private contractor earns revenue directly from the user (for example, toll roads). Once the contract has expired, ownership of the asset depends on the terms of the original contract, either remaining with the private sector contractor, or returning to the public sector. PFI differs from privatisation in the role the public sector retains and it differs from 'contracting-out' of services in that the private sector provides the capital asset as well as the services.

Since 1997 a series of Government guidance notes have been produced to standardise procedures and to try to ensure that public money is spent as effectively as possible. There is a standard procedure to be followed in the process of contract award, which comprises 14 steps, from establishing business need to contract management.[2] The public authority looks at a range of options for delivering the specified output, including a publicly funded alternative to PFI: A Public Sector Comparator (PSC) is used to estimate what a project would cost if traditional public sector procurement methods were used. [3] The use of a PSC to demonstrate value for money is now standard in PFI projects, but as we shall see below, can be controversial. General guidance on the standardisation of contracts has also been issued so that public managers benefit from experience, for example, in negotiating clauses to ensure that the public sector shares in any re-financing gains made by the private sector.[4]

The extent of PPP

The Labour Government promised and is delivering a large increase in public investment. Public sector net investment is set to increase to 2% of GDP by 2005–6, a five-fold increase compared with 1997-98. Total UK investment in public services will rise to over £46 billion in 2005–6, compared to £23 billion in 1997-98. The Government notes that PFI accounts for an estimated 10% of capital expenditure in 2002 and expects that over the next three years, PPP contracts worth at least £12 billion will be signed.[5]

Table 1 shows that by October 2002, there had been 524 projects signed with a total value of over £22 billion. Most of these have been signed since Labour came to power: Projects with a combined capital value of around £18 billion have been approved since May 1997.

Table 1: Signed deals by Department October 2002

Government Department	Capital Value £m	Number of Projects
Department for Transport	8944.25	31
Department of Health	2675.78	114
Ministry of Defence (MoD)	2352.47	45
Scotland	1945.8	73
Home Office	1698.6	43
Dept. for Education and Skills	1544.38	81
Dept. for Work and Pensions	930	7
Wales	437.6	26
Inland Revenue	390.8	8

[1] *Public Private Partnerships: The Government's Approach* 2000, pg 10
[2] *A Step-by-Step Guide to the PFI Procurement Process*, Treasury Taskforce, revised Nov 1999
[3] see *How to contsruct a Public Sector Comparator* Treasury Taskforce Technical Note No. 5 Oct 1999 and *Public Sector Comparators and Value for Money* Treasury Taskforce Policy Statement March 1998
[4] *Standardisation of PFI contracts*, Office of Government Commerce (OGC) October 2002
[5] Pre-Budget report 2002*, Steering a steady course: Delivering stability, enterprise and fairness in an uncertain world*, para 6.14

Government Communications Headquarters (GCHQ)	330	1
Office of Deputy Prime Minister	312.78	28
Dept Environment, Food & Rural Affairs	250.3	9
Lord Chancellors Dept	243.5	10
Dept for Trade and Industry	193.7	9
Northern Ireland	192.9	25
Foreign and Commonwealth	124.9	2
Treasury	118	1
Customs and Excise	83	2
Northern Ireland Court Service	65	2
Dept Culture, Media & Sport	43.9	4
Dept National Savings & Investment	37	1
Office of Government Commerce (OGC)	10	1
Public Records Office	n/a	1
Total	**22924,66**	**524**

Source: OGC Signed Projects List October 2002

Table 2: Status of signed Projects

PROJECT STATUS	**NUMBER**
OPERATIONAL	378
NOT OPERATIONAL	115
N/A	16
TBC	15
TOTAL	**524**

Source: OGC Signed Projects List October 2002

As Table 1 shows, The Department Transport: has the largest PPP/PFI capital expenditure, currently at nearly £9 billion, or 39% of PPP/PFI capital investment. Transport projects are dominated by the controversial Channel Tunnel rail link (which links the Tunnel to London), worth nearly £4.2 billion and the NATS PPP. Other projects signed so far include extensions to public transport systems such as the Docklands Light Railway and the Manchester Metrolink, and a series of major roads projects. PPPs are to play an important part in the funding of the Government's Ten Year Transport plan – around £56 billion is expected to be funded through private sector finance, including PPPs, over the next ten years.

The Department of Health has signed the largest number of PPP/PFI projects (114), with a capital value of over £2.6 billion. PFI is responsible for the biggest hospital building project in the National Health Service (NHS): Under the Labour Government 64 major hospital projects have been given the go-ahead under PFI, compared to 4 publicly funded schemes. 13 hospitals built under PFI contracts are already operational, and a further 11 are under construction. Smaller PFI projects include energy management, catering reprovision, provision of scanners and new administration systems.

Defence projects make up nearly 9% of PPP/PFI projects, with a capital value of over £2.3 billion. Significant projects include a range of helicopter training contracts, the Armed Forces Personnel Administration (a project to implement tri-service pay, personnel and pensions, worth £264) and a project to redevelop the MoD main building (415 million). Smaller projects include provision of water and sewerage services to Tidworth garrison, and some refurbishment contracts.

The Department of Education is responsible for 15% of projects with a capital value of £1.5 billion. In total 48 schools PFI projects have been signed with a total capital value of £1.3 billion, and covering 550 schools. These projects range from school building to school repair and running services such as IT services to schools. The trend in PFI in education is towards larger and higher value groups of schools, with the average value of successful bids rising to £42 million in 2003/4 compared to £33 million in 1999/2000. In Scotland, the schools projects are particularly important: Scottish Ministers have committed themselves to modernising 100 schools, mainly through through PFI, by 2003. 12 „first generation" PFI schools projects (about 80 schools) have a forecast investment value of more than £600 million and a lifetime expenditure commitment of more than £2 billion.

The Home Office has signed 43 PPP/PFI contracts, with a capital value of £1.7 billion. Its most significant projects have been the first DBFO prison building projects including HMP Altcourse (the Fazakerley prison project) with a capital value of £88 million, which have been billed as very successful. Less successful has been the £30 million Passport services contract.

One PFI area which is comparatively undeveloped at present is leisure, with only 5 signed leisure and cultural projects. However this area is beginning to develop, with the allocation of £90 million of PFI credits to the Department for Culture, Media and Sport (DCMS) in the 2000 spending review, followed by another £120 million a year later. The size of leisure projects has evidently been a factor in this slow start: The organisation set up to help local authorities pursuing PPP, the 4Ps, notes that the value of an individual leisure PPP/PFI project ranges from £5-£10 million and believes that new bidders would be attracted into the market if project values were in excess of £20 million.

Table 3 lists the largest projects signed so far by capital expenditure Apart from big transport projects, it can be seen that some of the largest projects are for redevelopment of government buildings: The Ministry of Defence (MoD) contract to redevelop its main building (capital value £415 million) involves moving over 3,000 staff into other central London accommodation, carrying out an extensive redevelopment of the Main Building, moving them back and maintenance until 2030. A contract with a capital value of £330 million to re-build the headquarters of the Government security agency GCHQ was signed in 2000. The redevelopment of the Treasury Main Building, with a capital value of £118 million consists of a 2-year refurbishment period followed by a 35-year concession to maintain the building and provide facilities management services. Under the PRIME project, which was signed in 1995 with a capital value of £665 million, ownership and management of buildings of the former Department for Social Security were transferred to the private sector, which now provides the new Department for Work and Pensions with fully serviced accommodation.

Table 3: Projects with a capital value of over £200 million

Name of project	Capital value £m	Department
Channel Tunnel Rail Link	4178	Dept for Transport
NATS PPP	800	Dept for Transport
PRIME[6]	665	Dept for Work and Pensions
PSRCP[7]	500	Home Office
Birmingham North Relief Road	485	Dept for Transport
Main Building Refurbishment	415	Ministry of Defence
Northern Line Trains	409	Dept for Transport
University College London Hospital NHS Trust[8]	404	Dept of Health
London Underground Connect	355	Dept for Transport
Second Severn Crossing	331	Dept for Transport
GCHQ Building	330	Foreign and Commonwealth
Home Office Central London Accommodation Strategy	311	Home Office
Armed Forces Personnel Admin Agency	264	Ministry of Defence
Glasgow Schools	225	Scotland
EDS/IT Partnership Agreement[9]	217	Department for Work and Pensions
M1-A1 Link Road	214	Dept for Transport
Croydon Tramlink	205	Dept for Transport
Lewisham DLR extension	202	Dept for transport

Source: OGC Signed Projects List October 2002

Despite the fact that there are some major PFI projects in operation, the fact remains that the bread and butter of PFI work lies in the smaller projects: In fact only 8% are worth over £100 million, with the majority (60%) being projects with a capital value of up to £20 million.

Government as an intelligent client

Although PFI is now firmly identified with Labour, it was in fact introduced by the previous Conservative Government. However, it had a very slow start and by May 1997, the number of projects signed had not reached 70. There were many problems, including excessive bidding costs, the absence of the right commercial and procurement skills in the public sector, the „universal testing rule" (under which no public expenditure project would be approved until it had been tested for PFI) which led in fact to many ill-conceived projects, and the absence of feedback of lessons learned in early PFI projects.

When Labour came to power in 1997 it committed itself wholeheartedly to PFI and initiated a series of reforms designed to modernise Government and develop better commercial skills. The new Government abolished the universal testing rule and commissioned Sir Malcolm Bates, Chairman of the Pearl Group and of Premier Farnell, to conduct a review of PFI. The Bates report concluded that there was a need for a strong central organisation, and so the Government created a Taskforce in the Finance Ministry, the Treasury. The TreasuryTaskforce was charged with supporting departments in the PFI process for a period of 2 years. It was to help check that projects were affordable for the public sector, including checking that the output requirements were appropriately specified, that risk was allocated to the party best able to manage it and that funding was likely to be forthcoming from the private sector. The Taskforce also advised on draft contractual terms and conditions, project resources and whether timetables were realistic, as well as monitoring the progress of projects.

A second review by Malcolm Bates, which was published in 1999, and a parallel review of all civil procurement led by Peter Gershon, Managing Director of General Electric Marconi, concluded that central support was still necessary and that there remained a shortage of the essential skills required to set up partnerships with the private sector. The reviews led to the

[6] The transfer of ownership and management of the buildings of the former Department for Social Security part of the Newcastle estate to the private sector
[7] Public Safety Radio and Communication Project
[8] Rationalisation of sites
[9] Provisaion of IT and telephony services to Employment service

projects arm of the Taskforce being replaced by a new organisation, Partnerships UK, and the policy wing of the former Taskforce being taken over by a new Office of Government Commerce. Partnerships UK (PUK) and the Office of Government Commerce (OGC) both became operational in 2000.

Partnerships UK is itself a PPP – a joint venture with the public sector owning a minority interest and the private sector owning a majority. It acts as a PPP developer, working with commissioning authorities in developing complex, large or high priority PPPs. It also has its own resources to provide financial backing to projects as a development partner and works with the OGC on guidance and the standardisation of PPP contracts.

The OGC is charged with improving the efficiency of all civic procurement, not just PPPs. It provides support for improving project procurement and contract management skills across Government, and runs a Gateway Review process which assesses projects at critical points – or ‚gates' - in development. The process is used to decide whether projects should proceed. Three Reviews take place before contract award and two concentrate on implementation and management of the contract.

There are also structures for supporting local authorities pursuing PPP/PFI. Although the bulk of PPP/PFI schemes and funded by central government, over 30% of PFI projects are actually delivered through local authorities. Through its Project Review Group, central government picks projects that will receive financial support, which comes in the form of a PFI credit once the contract is signed. Two organisations - the Public Private Partnerships Programme (the 4Ps) and the Improvement and Development Agency (IDeA)- support local authorities in developing PPPs and PFI and help them in negotiations with Government and the private sector.

The development of the institutional structure for supporting PPP/PFI was a response to the particular conditions in the UK and is generally viewed as having been very successful. Following the formation of the Taskforce, the PFI deal flow improved dramatically, as the following table shows.

Table 4: Signed deals by year

BREAKDOWN BY YEAR		
YEAR SIGNED	**NUMBER OF DEALS**	**CAPITAL VALUE £m**
1987	1	180
1988	0	0
1989	0	0
1990	1	331
1991	2	2.5
1992	2	508.6
1993	3	3
1994	3	10.5
1995	9	737.02
1996	33	5559.65
1996 AND 1997	1	14
1997	56	2155.19
1998	87	2758.52
1999	86	2386.04
2000	102	4080.41
2001	77	2986.01
2002	24	1034.88
N/A	19	172.43
TBC	18	5.3
TOTAL	**524**	**22925.05**

The strength of the Taskforce was that it was set up in a central organisation – the Treasury - which could by its nature co-ordinate right across the public sector. A key feature was that it had high level political support. The Chief Executive of the Taskforce, Adrian Montague (who came from Dresdner Kleinwort Benson) viewed having a sponsoring Minister and a unit within the Ministry of Finance as essential to the increase in PFI after 1997. Others support this view – the former Chief Executive of 4Ps Peter Fanning believes that before 1997 the failure of PFI was „as much a failure of Minister as of institutions“ because the Conservatives failed to appoint a powerful sponsoring Minister.

Moreover, the Taskforce was a specialist unit which helped to overcome the perceived ‚public sector culture‘ problem of a lack of commercial understanding and experience. Key figures from the Taskforce argue that the fact that the staff came from the private sector but were employed as civil servants was critical to the success of the Taskforce: they were „on the home side“. However it is argued that in the long term a problem was that the huge differences in salaries and lifestyle between the public and private sectors meant that the Taskforce would not have been able to keep staff brought in from the private sector indefinitely - therefore the subsequent formation of PUK had the advantage that it helped to keep them within the public sector, but under private sector terms and conditions

The process of an initial Taskforce, followed by the split in Taskforce functions between PUK and OGC - with OGC taking responsibility for policy work and PUK for project work- is generally viewed as having been a sensible development which responded to the particular conditions in the UK. Whereas some commentators believe that PUK will eventually take over the PPP-related responsibilities of the OGC, other disagree, pointing to the advantages of the separation of functions: The question in the PPP debate in the UK now is not whether PPP, but how much ? It is argued that this kind of decision cannot be made by the private sector and must be left to people on the public sector side who are protected from commercial pressures.

Making the case for PPP/PFI

In its major report entitled " Building Better Partnerships", the only independent think-tank review of PPPs, the Institute of Public Policy Research (IPPR) argue that „almost a decade after its inception, the PFI remains a relatively modest part of totally sponsored capital investment and total public spending on PFI contracts was forecast to remain small. Moreover there is no clear evidence that the build up of the PFI, much anticipated by government and dreaded by its critics, is accelerating". [10] However, as the report goes on to point out, most forms of PPP and especially the PFI remain highly controversial. Why is this ? What are the key issues and what is the focus of the debate in the UK?

Poll evidence shows that the public's main concern is how good public services are (rather than how they are provided). But, with the exception of education, voters say they have seen little evidence of improvement in public services since Labour came to power, and confidence that they will improve is decreasing. Discontent about the efficiency of public services gets mixed up with the PFI debate. There is often little or no distinction being made between 'under funding of public services', 'privatisation' and PPP/PFI. Pay claims, quality of service (eg NHS waiting lists) and 'privatisation' are discussed in the same breath. This is an issue that brings out real fears and core prejudices.

One problem is that the Government has given and continues to give mixed messages about the reason for PFI. The main argument put forward in favour of PFI is that it provides better value for money than conventional procurement, through greater private sector efficiency, whole-life costing of projects and appropriate transfer of risks to the private sector. But in the earlier days of PFI, there were claims that PFI allowed for "extra" investment within the limits of the Government's strict budgetary rules (the 'golden rule', which states that the Government will borrow only to invest and not to fund current spending and the 'sustainable investment rule' which states that public sector net debt as a proportion of GDP will be held at a stable and prudent level). It is now acknowledged that although the private sector pays up-front, the asset is ultimately paid for out of public funds, although politicians do still imply that PFI creates more investment. The IPPR illustrate the difference between finance and funding: when purchasing a car, most people will borrow money from a financing company (such as a bank), but they will have to fund the car from their own income – in the PFI financing comes from the private sector but all the funding comes from the public purse.[11] However, as the IPPR report points out, in reality "off-balance sheet financing" is still a driver in PFI (because if the private sector pays the capital costs up front then they do not show on the Government's balance sheet, even though they remain public liabilities). It is argued that in many cases there is a perception that projects will not be given the funds to go ahead unless they are done as a PFI project.

This does illustrate a major political problem: Despite its commitment to implementing PPP/PFI, the Government has never properly made the intellectual case for partnership (although the last 6 months have seen efforts to do this, perhaps in response to criticism). It is only really the IPPR that has made the case. Its report argues that „the case has yet to be won for partnership as a legitimate means of delivering high quality public services" and that „the centre left needs to regain its confidence in its ability to put forward a distinctive vision for public services, one that is based on finding new ways of helping the public sector to be enterprising". "*Building Better Partnerships*" argues that although this could be a ‚golden age' for public services, failure to make the case for universal public services and to deliver good public services could cause a political backlash – „If the case for universal public services cannot be won now it may soon be lost forever. To win this fight the case for public services needs to be made in terms of values and outcome rather than in particular forms of service delivery". The report argues that in its abandonment of Clause IV, Labour has accepted that the founding principles of the NHS are that it should be free, universal and comprehensive, not that it should be provided through a particular structure. However it points out that the rationale for PPPs appears confused, that unrealistic expectations have been created, that PPPs are sometimes „the only game in town", that the impression has been given that partnership is a punishment for failure; that the model for PPPs is too rigid; that PFI threatens to create a mono-culture and that PPPs raise the spectre of privatisation. In order to win the fight, it advises, the Government must re-make the case for public funding of social services; distinguish funding from provision; be open-minded about the case for partnership and diversity; and establish criteria for assessing partnerships.[12]

The Government's failure to do this has led to criticsm not only from the opposition but also from its own backbenchers. The House of Commons Public Administration Select Committee recently finished an investigation into „The Public Service Ethos". It concluded that the Government has not so far produced a consistent and coherent policy for the involvement of the private sector in public services, and that it is not clear whether the private sector is seen as a remedy for particular cases of public sector failure, or as a routine ingredient of public service provision. It notes the extent of, and justification for, private sector involvement varies widely within and between departments.[13] It argues that „Government in one voice suggests that the existing ethos of the public services represents a blockage to reform, while in another voice it says that this ethos represents an asset to be built on. Such mixed messages are clearly unhelpful in building and communicating an understanding of the Government's reform programme". [14]

Similarly, in their report on private sector involvement in delivery of healthcare, the House of Commons Health Select Committee was concerned that „PFI is still being blamed for numerous ills not directly related to it whereas the many benefits ascribed to PFI have yet to be proved. The time has come for a more rational and objective debate, and it is the responsibility of the Government to take a lead in achieving this".[15]

[10] IPPR *Building Better Partnerships* 2001, pg 72
[11] *Building Better Partnerships* IPPR 2001 pg 79
[12] *Building Better Partnerships* IPPR 2001, chapter 1
[13] House of Commons Public Administration Select Committee *The Public Service Ethos,* 2002, HC263-I, para 35
[14] House of Commons Public Administration Select Committee *The Public Service Ethos,* 2002, HC263-I, para 37
[15] *The role of the private sector in the NHS*, House of Commons Health Select Committee May 2002HC-308-II, para q in List of Conclusions and Recommendations

Be bold ?

Speaking about delivery of public services in his conference speech in October, Tony Blair urged his party towards greater reform - „We are at a crossroads: Party, Government, country. Do we take modest though important steps of improvement ? Or do we make the great push forward for transformation ? I believe we are at our best when we are at our boldest. So far we've made a good start but we have not been bold enough". But at the same time there are voices calling for a slowdown in the direction the Government is taking. The major problem now for the government is that PFI, in the words of one commentator, "serves as a conduit for general concern about the direction the government is going on in public services".

Before focusing on the headline-grabbing problems of PPP/PFI it is important to point out that there is in fact quite a broad range of support for the use of partnerships and the private sector to deliver public services in the UK. National Audit Office[16] reports seek to assess value for money of projects and recommend where improvements could be made. House of Commons Select Committees[17] also monitor the implementation of PPP/PFI projects and although there have been some very critical reports, criticism tends not to revolve around practical problems or the Government's approach rather than a critique of partnership. The IPPR's report criticised the Government's approach to the use of partnerships, but supported the extension of partnership: In fact, the report is an advice manual on how it should or could be done. Business and employers associations support PPP/PFI and there is even support in some quarters of the union movement: The old engineering and electrical union, AEEU, now part of the new union Amicus, has supported the extension of the private sector in some areas.

Within the Parliamentary Labour Party, the picture is mixed: while the majority does not actually oppose PPP/PFI, there are growing concerns about the direction the Government is taking. People are nervous about too much private sector influence in the delivery of public services. However, outright opposition to the whole idea of PPP/PFI only comes from a handful of MPs. Two chairs of influential Commons Select Committees have spoken out against the government.[18] And there is a group of „usual suspects" (the small group of left-wing MPs plus a collection of ‚ndependents who do not toe the party line) who criticise the Government on many issues, including PPP/PFI. For example, at a conference designed to „challenge the prevailing market-led orthodoxy" which was attended by members of the left-wing Campaign group in July 2002, PPP/PFI featured heavily on the agenda.

The majority of Labour MPs, in the words of one „have got used to PFI. Most people find it very useful. We've had two PFI hospitals built, which we wouldn't have had otherwise". Another said „when you see it up and running in your constituency, your criticisms fall away". However there is some concern in the party about the possible direction the Labour Party could be taking. There is concern that the Government is rushing ahead in some areas without proper consideration, particularly plans for top-up fees for ‚elite' universities, autonomy for specialist schools and the „ueber-Blairite" direction of private involvement in the NHS. This issue of further expansion of private influence in the public sector could cause problems in the future. In the words of one senior Labour figure „PFI is not at present a focus of opposition for Blair because there is enough support for it. But it could be trouble if Blair pushes it too far. There may be a limit to this kind of thing". [19]

One scheme that has caused concern is Foundation Hospitals, which are the project of Health Secretary Alan Milburn. The idea of Foundation Hospitals is that they are given greater autonomy than others in return for better performance. The hospitals will be able to hire staff and buy their own equipment, but Milburn has also wanted them to be able to borrow on the open market „off the balance sheet", without Treasury approval, to invest in services. However the Treasury argues that if hospitals are allowed to borrow off the balance sheet, the Government will have to pick up the bill if things go wrong. Some government sources have suggested that there is an inherent conflict between PFI, where the private sector takes the risk, and giving Foundation Hospitals financial freedom.[20] A row between the Department of Health and the Treasury on this subject became increasingly public during Labour Party conference in October last year and the argument was then reported as turning into an argument between Blair and Finance Minister Gordon Brown, with Blair backing the Department of Health against Brown. A Blair aide was quoted as saying „This is not some itsy-bitsy debate about detail. This is about what the health service and health care system looks like in the next decade and beyond".[21]

Problems about private sector involvement in the delivery of public services has been seen as a significant part of the much-discussed problems between Blair and Brown: their relationship has been reported as being „like a marriage that has gone very badly wrong"[22]. Critical differences between Blair and Brown on the subject of the direction of reform have been reported, with a fear in the Brown camp that a „two-tier England" could be created if the role played by the private sector in the provision of health and education is not limited. Frustrations in the Brown camp were revealed in November when Brown's chief economic adviser publicly said there were „grave risks" to the public service if the use of private sector finance or discipline was taken too far[23].

Brown is seen as a politician who „likes to keep his head down" on contentious issues. Viewed as being closer to the unions than the ultra-reformist Blair, his concerns are reported to be more traditional. However, as can be seen below, he did go on the offensive against the unions before and at Labour Party conference over PFI, and a recent speech attempted to set out the intellectual case for private sector involvement in the delivery of public services. In the speech Brown argued that „By stating our vision clearly, we can bring to an end the sterile and self defeating argument over PFI where producer interests have often been wrongly presented as the public interest; move forward from what has been a debate insufficiently explicit on the role of

[16] The National Audit Office scrutinises public spending on behalf of Parliament. It is independent of Government and audits the accounts of all government departments and agencies as well as a wide range of other public bodies

[17] House of Commons Select Committees are made up on members from all parties but generally have a Government majority. They monitor the work of Government departments.

[18] David Hinchcliffe, Labour chairman of the Health Select Committee, was outvoted by Labour backbenchers on the committee in May 2002 when he wanted to delete paragraphs in the Health Committee report defending the government position. Gwyneth Dunwoody, chair of the Transport sub-committee looking into the London Underground PPP gave a fiercely critical speech in the Commons in July, in which she said "Beware this is a bad scheme, which can still be dropped and should be abandoned".

[19] Interviews with Labour MPs

[20] *The Times* 3rd October 2002

[21] *Financial Times* 3rd October 2002

[22] *Observer* November 24th, 2002

[23] *Independent* November 5th, 2002

public and private providers in some of our public services; and, most of all, open up a broad and challenging agenda for prosperity and social reform". Echoing Tony Blair's conference speech, he said that „To hold old, discredited dogmas about what should remain in the public sector and how the public sector operates, or to confuse the public interest with producer interests, makes no sense". To the annoyance of the left wing and the unions, he argued that a progressive government can enhance markets in the public interest. But he also set out clear limits to the extension of the market in the health sector, arguing that market failures and policies of profit maximisation would lead to a two tier health care system.[24] The significance of this speech is that Brown is setting limits to the role of the private sector at a time when Blair is perceived to be rushing further towards increased private influence: The prudent businessman or the bold adventurer. Who will win this argument ?

Within the civil service too there has been a feeling that the whole PFI issue should not be pushed too far, especially because of the controversy over off-balance sheet funding: If a project is financed under PFI, the capital expenditure does not normally count as public expenditure, although the charges levied by the private sector operator for the use of the building and services that are provided do. There is some concern about the scope for a government to use PFI to disguise the underlying position of public finances. In response to such criticism, the Treasury now publishes forecasts of the committed expenditure for public services flowing from private sector investments signed under the PFI (see appendix 3). In 1998 the Accounting Standards Board stated that the capital value of PFI schemes should appear on the Government's balance sheet. However the Treasury subsequently issued a note ‚How to account for PFI transactions' which allowed most PFI transactions to be excluded from Government borrowing figures on the grounds they were „operating leases" not „finance leases".[25]

The union campaign

The campaign conducted by GMB and Unison against PFI has had an impact on the debate in the UK. It has struck a public chord when service is felt to be bad ('privatisation' is blamed for many things it has nothing to do with); it also hides the fact that not all unions are as hostile to PFI as these two. It is a well-run campaign, complete with a professional website and continual dissemination of anti-PFI briefings.

This campaign has to be seen against a background of increasing industrial unrest and trade union muscle flexing in the UK. After Labour was elected in 1997, there was a honeymoon period between the government and the unions. But gradually the unions have come to feel that the Government's outlook is too 'business oriented' and there is a feeling of betrayal that a Labour Government should seemingly turn its back on its historic partners. The newly elected Trade Union Congress (TUC) general secretary Brendan Barber recently accused the Government of being "over-preoccupied" with the concerns of business.[26] An political commentator writing about the Government approach has summed up this feeling very well, "Labour took money from business and promised an economy that would be, above all, good for business. Its most important leaders revealed a personal infatuation with business leaders ....Blair and Brown believed businessmen were best. Union leaders were all very well, but should have nothing to do with running anything. In this respect there was a seamless continuation of the Thatcher ethos.... The party promotes private businessmen, not public servants, as the model to be imitated"[27]

Relations between the Labour Party and its historic partners are now very strained. Labour's general secretary recently warned that the party and the unions were "sleepwalking to a catastrophe without recognising it".[28] The fire fighters' union is holding its first strikes in 25 years (they are asking for a pay increase close to 40%) and the last year has seen strikes by local government workers and transport workers. The unions are openly questioning their links with the Labour party, and some are set to hold ballots on donations to Labour (the first for ten years). Some unions have already cut financial support (for example, the rail workers' union RMT withdrew financial support from the constituency parties of 13 MPs, including Deputy Prime Minister John Prescott and Leader of the House Robin Cook, because they would not back its policy demands including re-nationalisation of the rail network and the abandonment of the London Underground PPP). Worse still for Labour, a £40 million deal with the unions to fund the Labour Party (which is £6 million in debt) for the next five years appears to have been lost because of union anger at the Government stance on the fire-fighters' strike. Tony Blair is reportedly considering plans to introduce state funding for political parties.

A series of elections has brought in a new set of union leaders, known as "the awkward squad", who are critical of New Labour and Tony Blair. Examples are Bob Crow, left-wing leader of the RMT ("Labour are only marginally better than the Conservatives in power"[29]), Bill Hayes, recently elected general secretary of the Communication Workers' Union, Mark Serwotka, PCS Civil Service union, and Andy Gilchrist of the Fire Brigades Union (who in December 2002 addressed the hard-left Socialist Campaign Group rally and linked the fire-fighters strike with his desire to replace the Blair government with a "real Labour" one).[30] Most shocking of all to the government was the ousting of government loyalist Sir Ken Jackson as general secretary of Amicus (now the country's second biggest union with over a million members) by former Communist Derek Simpson, a result described as likely "as Saddam losing in Baghdad Central".[31] Derek Simpson, attributed his surprise victory to the former leadership being out of touch with its members, saying "the Labour party has the same problem as our union; it's divorced from its roots".[32]

2003 will see leadership elections for the TGWU (Transport and General Workers Union) and the GMB, when leaders Bill Morris and John Edmonds retire. Union sources believe this will guarantee that PFI will be a big issue during the campaigns, warning that "people who say nice things about Tony Blair lose elections". Speculation is that John Edmonds' successor at the GMB will come from the left, as will Bill Morris's successor at the TGWU.

[24] *A modern agenda for propserity and social reform*, speech by Gordon Brown to the Social Market Foundation 3rd February, 2002
[25] House of Commons Research paper *The Private Finance Initiative* 01/117 Dec 2001
[26] *Independent* 31st December 2002
[27] Hugo Young in *The Guardian* September 11th, 2001
[28] *Independent* December 31st, 2002
[29] *Independent* July 21st, 2002
[30] *Independent* December 2nd 2002
[31] *Guardian* 19th July, 2002
[32] *Guardian* 19th July, 2002

There is a range of opinion within the union movement about PFI, described by one union official as a spectrum with the GMB and Unison at one end and the AEEU (now part of Amicus) on the other end. The AEEU recently produced a survey showing the exact opposite of the GMB and Unison surveys: it noted that it represents over 20,000 members in the NHS and that their members have been transferred to private contractors in every PFI scheme. 500 have been transferred since 1997, with an additional 500 expected to transfer in the next two years. The survey, which was conducted on 9 NHS PFI sites found that 66% of transferred staff felt protected in their employment with the new private sector employer, 66% felt as valued as in the NHS Trust, 77% felt secure in their employment and 86% thought that the majority of staff would be happy to stay working for the new employer in the long run[33].

At the same time there is no doubt that there are serious issues involved for employees in PFI companies and, as the IPPR points out, it is widely recognised that PPPs will not receive public or political support if they are seen to impact unfairly on the workforce. One major worry people have is that value for money efficiency savings will be made at the expense of the workforce, either through lower staffing ratios or lower wages. A recent Unison report on PFI argues that PFI "profits from people". It argues that the "higher costs" of PFI put pressure on public authorities to keep costs down, and that the labour costs of the services is a major source of saving[34]. The wages and conditions of workers who are transferred out of the public sector into the private sector are protected by the Transfer of Undertakings (Protection of Employment) Regulations (TUPE). However the private sector contractor may hire new staff on terms and conditions that are less favourable than those of the transferred workforce, thus creating a „two-tier workforce".

There have been steps towards resolving the two-tier issue. Last year Unison reluctantly accepted the Retention of Employment model in the NHS (whereby roughly 85% of the workforce remain NHS employees even if a hospital is built under PFI) although the GMB rejected the proposal. The model has the advantage that it protects employees' rights, but there are worries that it could compromise value for money and cause complications in management structures. Separate talks about a draft code of practice on the two-tier workforce in local government are going on but have run into problems. The Confederation of British Industry (CBI) has warned that private companies would not take over the running of council services if ministers settle with unions on the issue of new staff taken on by private contractors being given „no less favourable" conditions than existing staff. John Cridland, CBI's general secretary, said „Restrictive working in many parts of the public sector have proved to be inefficient. We do not believe that the private sector should follow that particular model". Unison leader Dave Prentis said that the Government was heading for an "almighty row" unless agreement was reached on this issue.[35]

Many people believe that the Labour Government has mishandled the whole issue of PFI and the unions, buying itself a big headache in the process. A general view is that if the Government manages to successfully conclude the local government two-tier workforce talks, it will take some poison out of the PFI arrow and calm the more ‚sensible' voices within the movement. However this is a fight which should not have taken place at all and would not have taken place if the Government had considered workforce issues more deeply at the beginning. This failure led to some very public problems at the TUC and Labour Party conferences.

The TUC conference took place in September 2002 against a background of increasing government/union tensions. During a debate on PFI , unionists queued up to support a motion calling for a halt to projects involving the private sector. Tony Blair's speech to the Conference was greeted with silence by many delegates. Blair declared that his New Labour project had been the route to victory and remained the party's best chance of success: he said it would be ironic if after 18 years of being „kicked from pillar to post", trade unions turned their back on social partnership with a Labour government – „Partnership doesn't make the headlines but the vast majority of trade union leaders and members know it does far more good than a lot of self-indulgent rhetoric from a few that belongs quite frankly in the history books".

The TUC conference proved to be a warm up for Labour Party conference. The theme of Labour's October 2002 conference was „schools and hospitals first", which put public service reform firmly at the centre. In the run-up to conference, Blair operated a dual approach of setting the reformist new Labour agenda but at the same time tacitly or explicitly acknowledging union and „old Labour" concerns. An example of this was a pre-conference speech he made in September when he promised to „redistribute power, wealth and opportunity", to combat poverty and deliver public services. This speech was widely reported as being the first time Tony Blair had ever promised redistribution of wealth and seen as a sop to old Labour because of the problems he was having over Iraq and public service reform.

However the remaining time before the start of Labour conference saw an increasing Blair/Brown offensive against the unions on PFI and public sector reform. Unison submitted a conference motion to Labour conference calling for a halt to PFI projects, a motion which was supported by the TGWU and the GMB. Gordon Brown entered into a public row with the unions about this, saying that it was completely unacceptable to halt hospital, school, roads and rail projects, denying the public the service they need – „We said schools and hospitals first. Hospitals and school building will go ahead".[36] and „there will be no moratorium, no delay, no hold-ups. We will press ahead".

In a Fabian society pamphlet „*The courage of our convictions*", published just before Labour Party conference, Blair set out the arguments for public service reform and warned that without reform tax-funded public services will be lost. This pamphlet was criticised for failing to make the case for PPP/PFI - one commentator wrote „He is right to warn that if the public services don't deliver, their destiny is privatisation under the Tories. Yet after 10,000 words he has failed to explain to the very good public service managers how and why private management delivers better"[37]. In an interview, Blair said that the 'British disease' of pessimism was undermining progress towards better services and a strong economy. He argued that the public services needed fundamental reform to make them more consumer-friendly and many people's thinking was stuck in the 1940s.[38]

As Labour conference started it became clear that there were some differences of opinion on the Unison motion. While the ‚Big 3' unions were united in support for it, Amicus was expected to abstain, and it was clear that opinion in the constituency parties

[33] House of Commons Select Committee on *Health The Role of the Private sector in the NHS* May 2002, HC 308, Appendix 26
[34] Unison report PFI: Failing our Future september 2002, pg 20
[35] *Guardian*, January 16th 2003
[36] *Guardian* September 19th 2002
[37] *Guardian* September 27th 2002
[38] *Observer* 29th September 2002

was mixed: 8 pro-PFI motions from constituency Labour parties had been submitted as a counterbalance to the Unison motion, and a BBC survey of 202 constituency party chairmen or women showed that 92 wanted PFI contracts to continue while 79 wanted to call a halt. The night before the Unison motion was due to be debated, the Big 3 withdrew their call for a halt to PFI and changed the motion instead to a call for an independent review of PFI. The background to this change was the fear, particularly amongst construction workers, that an end to PFI would mean job losses. The milder motion also ensured more support and therefore a government defeat. This defeat on PFI was only the second conference defeat for Tony Blair since he became Labour leader. 67% of delegates backed the union motion, with just under 33% against. However a breakdown of the results showed that a majority of constituency delegates had rejected the union call.

Following the government defeat, a row erupted when it became clear that the government would take no notice of the PFI defeat. Labour chairman Charles Clarke said that „The policy of the Labour Party is not the same thing as a resolution passed by the Labour Party conference“[39].

Blair's keynote conference speech took place a day after the PFI defeat. Far from being put off by problems over public sector reform, Tony Blair had been signalling that he was ready to step up the pace, and his speech, which was headlined „Blair message: Be Bold“ clearly proved that he was not prepared to be side-tracked by union opposition to reform. Blair called for an end to the „one size fits all“ mass production public service. He urged the party and the unions to join his crusade on public services saying „The radical decision is usually the right one. The right decision is usually the hardest one. And the hardest decisions are often the least popular. Just as mass production has departed from industry, so the monolithic provision of services has to depart from the public sector".

How successful is PPP/PFI ?

It can be difficult to make a proper assessment of PFI in the UK because the debate has been so contentious. The dispersal of PFI expenditure means that it is proportionately more important in some areas (which attract more public attention) than in others: For example, since 1997 64 PFI contracts have been signed in the hospital building programme, compared to 4 which were conventionally financed. In transport, half the total volume of PFI expenditure went on the controversial Channel Tunnel rail link.

Health - particularly hospital building - has been a bloody PFI battleground. Lurid stories about PFI failues appear in newspapers, stories which are not always true. The CBI is concerned that there is a lack of balance in presenting the record of private sector delivery, citing as an example press reports about the opening of the Cumberland Royal Infirmary; press reports claimed flooded wards, raw sewage in operating theatres and many other failings. The reality was that one broken pipe damaged four tiles, and there was a waste overflow in an ancillary room, not an operating theatre. The CBI concludes that these scare stories „stifle informed debate about how to make progress in an environment where the overall quality of public debate is very poor“.[40] The recent Health Select Committee report was concerned that the debate over PPPs and PFI in health has become polarised „with exaggerated claims being made on both sides of the argument in a climate not always conducive to rational analysis“. Taking as an example the debate on two of the first wave of PFI hospitals in Carlisle and Durham, the Committee notes that „it is difficult to steer a course through this field of claim and counter claim“. Further the Committee was „disappointed at the lack of evidence backing many claims made“ and went on the single out the research unit led by Professor Pollock, the leading academic critic of PFI, for their lack of sound research and analysis which „is additionally worrying because it has been the source of advice for many groups including unions and professional associations, all of whom have used parts of the Unit's work as a justification for their antagonistic attitudes towards the private sector“.

An example of where the debate has become confused is over bed numbers. Critics of PFI claim that PFI hospitals have led to a reduction in bed numbers. In fact as the IPPR have pointed out, there is no evidence to support this assertion, because in PFI it is the public sector that determines the outcomes desired (eg bed numbers in a hospital project) not the private sector. The House of Commons Select Committee on Health regretted that PFI has become a „convenient scapegoat“ for poor bed planning.

<u>Value for money ?</u>

The most important question in any assessment of how successful PPP/PFI is is whether PPP/PFI gives value for money: The justification for partnership with the private sector is that it produces savings over conventional expenditure. In support of PPPs, the Government argues that traditional public sector procurement can be inefficient and expensive. Examples cited of conventional projects which have run into problems include the Trident Submarine Shiplift and Berth, which overspent by £214 million and was 2 and a half years over schedule, and the Jubilee Line extension (London Underground) which was £1.4 billion over budget and 2 years behind schedule.[41]

Can the private sector do it better ? After all, the cost of borrowing for the private sector is higher than for the public sector (although the IPPR point out that the extra cost of private as opposed to public finance may amount to only about 2% of the total costs of the project – „Clearly if the PFI project can deliver significant efficiency savings it should not be hard to cover these extra financing costs“[42]). Further, PFI projects can also overrun in time and costs. But according to the Government the private sector is more efficient in a number of ways: It can be more innovative in design, construction, maintenance and operation over the whole life of the project: It can invest in the quality of the asset to improve long term maintenance and operating costs (under PFI the ‚whole life costing' of a project, including long-term maintenance, is crucial): It can create greater efficiencies and synergies between design and operation. Finally, it can manage risk better - achieving value for money through PFI depends on appropriate transfer of risk to the private sector (for example, the risk that a project will overrun in timing and costs).

That is the theory but there is big debate in the UK about whether it this is true and about how to assess and define value for money. In the first place, according to the IPPR, out of the 378 PFI projects completed by central and local government, just 23

[39] *Independent* October 2nd, 2002
[40] *The role of the private sector in the NHS*, House of Commons Health Select Committee May 2002HC-308-II, Appendices to minutes of evidence
[41] *Public private Partnerships: The Government's Approach* pg 18
[42] *Building Better Partnerships* pg 86

have had any independent examination of value for money by official audit bodies[43]. There is growing disquiet in the PPP community about the Government's failure to create a body of information about the progress of PPP projects that is regarded as uncontestable.

Although value for money is supposedly the reason for projects to proceed along the PFI rather than the conventional route, it is argued that many projects go ahead because the public sector managers involved do not believe the project will get the go-ahead any other way – that PFI is „the only show in town" This can mean that the Public Sector Comparator – theoretically an exact science, with strict Government guidance on how to prepare it – will not be prepared with much conviction. Apart from these political pressures, there are other problems with the preparation of a PSC, most notably whether it is competently done in practice. The preparation of PSCs is not even really supported by the Government's own National Audit Office (NAO): NAO staff say that although a PSC can aid understanding of a bid, it should not be used to produce a single figure – huge amounts of money are often put into preparing a PSC, but little effort into understanding what it actually means. They are concerned that the PSC is treated as a pass/fail test, when the Treasury's guidance clearly states that it should not be so. According to a top NAO official, the majority of authorities construct a „highly elaborate figure which is spuriously precise if not wrong". He argues that although a lot of emphasis is put on producing figures to show that costs would be lower under PFI projects, the real reasons for choosing projects are often strategic: the private sector is seen as more efficient and will be chosen anyway. The House of Commons Select Committee on Health report found that „the inadequacy of the PSC appears to be one of the few areas that united the majority of our contributors on PFI".

One experience which was said to have „horrified" National Audit Office officials was the construction of the comparators for the London Underground PPP. This project has been dogged by controversy and delays. No one disputes the need for new investment in the London Underground system, which is overcrowded, inefficient and dirty. What is disputed in the means of achieving more investment. The PPP splits the Tube infrastructure into three parts (separating control of the various lines) which will be leased to two consortia – the Metronet consortium and Tube Lines. The PPP will run for 30 years, with the companies responsible for the infrastructure, but train operations remaining in public hands. £12 billion of public money will be backed up by £4 billion of private sector funds as the consortiums repair and maintain the network over the next 15 years. The contract with Tube Lines was signed in January, and the contract with Metronet is expected to be signed in the first half of 2003. The PPP has been the focus of several time-consuming and expensive legal challenges from Mayor of London Ken Livingstone, which have delayed the whole process, and the subject of endless critical press articles. Approval of the plans was finally given in February 2002 when the Secretary of State for Transport told Parliament that "Over the first 15 years of the contract, London Underground will save £2 billion, compared to traditional public funding … What is more, the contracts will mean faster and more reliable tube journeys than the alternatives".[44]

The £2 billion savings figure mentioned by the Secretary of State was produced by a PricewaterhouseCooper report, backed by an independent review by Ernst and Young. The figures have been harshly criticised by many commentators, and by the Transport, Local Government and the Regions Select Committee, which was concerned that there is no 15 year public sector comparator on which to base the £2 billion savings claim – "Neither London Underground nor Ernst and Young were able to support this claim". The report concluded that " the figures quoted by the Secretary of State have no basis in any of the published reports. The apparent continued dominance of the highly constrained financial analysis as the basis for the decision-making process is ill-founded and mistaken".[45] In addition, MPs were worried that no serious alternative to the PPP was developed, and the Transport, Local Government and the Regions Select Committee report concluded that "the failure to develop any alternative plan meant that the value for money test could only ever have one answer".[46]

So there are a lot of problems producing a good value for money estimate and in assessing whether a project that is up and running really is producing value for money. But the comparison with the PSC is still an important tool in independent assessments of value for money, particularly as PFI is still at a comparatively early stage. The value for money evidence is mixed. The IPPR's survey of December 2002 found that of the projects which had been independently assessed, prisons and road schemes have tended to demonstrate value for money, although the results for schools and hospitals are much less impressive. Of the 5 roads projects assessed, two were not expected to make savings, but the other three were expected to make savings of 15%, 21% and 31% respectively. Of two prison projects assessed, one was expected to make a 17% saving (the other just 0.4%) Two major defence projects were expected to make 16% and 23% savings respectively and the PRIME project 22%. The National Savings PPP with Siemens Business Service is expected to make a 12% saving. The two hospital contract surveyed were expected to make savings of 3% and 4% respectively and the schools projects in Scotland savings ranging from 2% to 9%.

The National Audit Office report „Managing the relationship to secure a successful partnership in PFI projects"[47] surveyed authorities and contractors responsible for managing 121 PFI projects where contracts had been let prior to 2000. It sought to answer the question of whether authorities manage their PFI relationships to secure a successful partnership, including whether the public sector receives value for money. Its conclusion was that most authorities (81%) said that value for money was currently satisfactory or better. However as the House of Commons Public Accounts Committee commented in its report on the NAO report, „ having entered into the contracts authorities were not likely to admit they had got it wrong". The Public Accounts Committee was also concerned to note that 23% of the authorities surveyed by the NAO considered that value for money was not as good as at contract letting ie there had been a decline in the value for money after contract letting. It argued that better evaluation is needed of PFI projects in progress and that the results of these evaluations should be monitored by the OGC to enable it to „refine the government's approach to the development of future PFI projects".

[43] IPPR research published 10th December 2002

[44] Quoted in House of Commons Transport, Local Government and the Regions Committee report *London Undergound – the Public Private Partnership: Follow Up* HC 680, para 3

[45] House of Commons Transport, Local Government and the Regions Committee report *London Undergound – the Public Private Partnership: Follow Up* HC 680, para 8

[46] House of Commons Transport, Local Government and the Regions Committee report *London Undergound – the Public Private Partnership: Follow Up* HC 680 para 14

[47] *Managing the relationship to secure a successful partnership in PFI projects*, NAO November 2001

Risk transfer

The appropriate transfer of risk is a crucial factor in the way PFI is supposed to achieve value for money, but in some instances risk has actually been transferred back to the public sector, which has had to bail out the private sector. Notable cases include the Channel Tunnel Rail Link, a contract that was originally signed in 1996. In January 1998 the private company responsible. London & Continental Railways asked for an additional £1,200 million in grants from the Government. This was refused but later in the year the Government was forced to give a government guarantee against £4 billion of bonds to keep London & Continental afloat. Highly controversial now is the National Air Traffic Services PPP (NATS). This ran into big trouble after September 11th, and has been hailed by Unison as „a privatisation too far". 46% of NATS shares were sold to 7 airlines in March 2002 against the advice of the Civil Aviation Authority, which predicted that the business plan would fail in the event of an airport disaster or deep recession. A cash crisis inevitably developed after September 11th and NATS was given an emergency state loan of £60 million. The House of Commons Select Committee on Transport, Local Government and the Regions criticised the PPP in July, saying that the financial structure created by the PPP (with its high level of debt) inflated the company's difficulties after September 11th and that the Government failed to heed the warnings its was given.[48] Similarly a National Audit Office report said that the Government should have heeded warnings that the financial structure was not robust enough[49].

In both the United Kingdom Passport Agency (1997) and the National Insurance Recording System 2 (1995) deals, the contractors failed to deliver the service required, yet costs were borne by the Government. In the re-negotiation of the PFI deal for the Royal Armouries Museum in Leeds, the public sector had to bail out the private sector with an extra £10 million to keep the museum open when the private contractor ran into debts.

Some of these problems can be put down to early learning experiences and will not necessarily be repeated. As the House of Commons Public Accounts Committee noted there is now a much better understanding among public sector clients that certain types of risk could not be transferred, particularly the ultimate responsibility for delivering a public service. Further, under the standardisation of PFI contracts now being implemented, there were termination provisions that defined the circumstances in which an authority could terminate the contract where the contractor was in default for not delivering a public service.[50] However there can still be problems relating to risk allocation, as the NAO recently found: in some projects there is disagreement between authorities and contractors on whether risks have been allocated to the party best able to manage them. In their survey of current PFI contracts, only two-thirds of contractors thought risks had been allocated properly and contractors told the NAO that risk allocation was an area where there were often problems. For example, the Business Services Association told the NAO that risk allocation is the biggest area of concern in many PFI projects and is often misunderstood by the public sector. [51]

Standards

There have also been questions raised about standards in PFI projects. For example, many PFI schemes in the IT sector have hit problems. The Unison report „Failing our future" September 2002 lists 9 IT projects that have „been embarrassing failures" including a new computer system at the Child Support Agency (£50 m over budget, and delayed) the Benefits Agency (£1 billion ‚cost of failure') and the Immigration and Nationality directorate casework programme (£77 million). It was recently reported that the Treasury is now considering an alternative to PFI for government IT projects, where the Government would retain a greater control over an IT project and might issue a number of smaller contracts instead of one mega-deal.[52]

Some school building has also been criticised. An Audit Commission[53] report has studied 17 of the first 25 PFI schools with a dozen traditionally built schools opened over the same period.[54] It found that the quality of school buildings built via more traditional means was on average better than the early PFI schools and there was little evidence of design innovation. Unit costs varied widely, with no clear-cut differences between PFI and traditional schools in construction or running costs. Risk had been reallocated but important features and risks were sometimes left out of project specifications, and early PFI schools were not delivered more quickly than non-PFI schools (although they have been delivered on time). Similarly, the Government's watchdog the Commission for Architecture and the Built environment (Cabe), has said that the PFI process could usher in public facilities that are badly designed, lack innovation and fail to embrace advances in medicine and technology. Cabe says that many PFI schools are like ‚sheds without windows' and fail to comply with best-practice standards of natural light. Classrooms, which should be no less than 55 square metres, tend to be much smaller. It says that the PFI bidding process fails to take enough account of design and that public sector procurers fail to specify exactly what they need.[55] However the Audit Commission report also found that teachers, parents and pupils were overwhelmingly pleased with the new schools, and it should be emphasised that the report looked at early PFI projects. Also on the positive side, a recent NAO report which looked at construction performance in PFI projects found that PFI projects have tended to deliver price certainty for departments and timely delivery of good quality assets (although it was not possible to judge whether the same results could have been acheived using a different procurment methods).

Delays

Some projects have experienced serious delays. For example it was reported in October last year that about half the Army's new Apache attack helicopters, bought for £3 billion, will have to be taken out of service for up to 4 years because pilots cannot

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48 *NATS' present finances*, Select Committee on Transport, Local Government and the regions July 2002, para 11
49 *The Public Private Partnership for National Air Traffic Services Ltd*, NAO July 2002 HC 1096
50 House of Commons Committee of Public *Accounts Managing the relationship to secure a successful partnership in PFI projects* 2002 HC 460, para 19 - 20
51 *Managing the relationship to secure a successful partnership in PFI projects*, NAO November 2001, HC 375, para 1.11
52 *Independent* November 3rd, 2002
53 The Audit Commission is the independent watchdog that monitors whether public money is spent economically in local government, health and criminal justice
54 Audit Commission *PFI in schools: The qualtity and cost of buildings and services provided by early PFI schemes* January 2003
55 *Observer* October 6th, 2002

be trained in time to fly them. The NAO said that although the aircraft were being delivered on time, a PFI deal to train the aircrew was three years behind schedule and that the Army could face a „significant capability gap“.[56]

The House of Commons Public Accounts Committee has found that the scheme to refurbish the Ministry of Defence's headquarters is costing almost £100 million more than originally budgeted because it took civil servants 16 months to close the deal. When the Modus consortium was selected as preferred bidder in January 1999 the cost of the refurbishment was put at £647million and the Ministry of Defence expected to save £25 million compared to the PSC. But by the time the deal closed in May 2000 the cost had risen to £746 million, mainly because the financial markets had pushed up the debt financing costs by £60 million. Expected savings from the project are now put at just £100,000 and the Public Accounts Committee concluded that „Reducing the length of the period it took the MoD to close the deal, postponing the choice of finance to the end to get the cheapest form available, and a cannier approach to the financing markets prior to closing the deal all might have helped secure savings on this project“.[57]

„Excessive profits“

Another issue which has added fuel to the PFI debate is the idea that private contractors make ‚excessive' profits from the public sector. This has been considered by the House of Commons Public Accounts Committee,[58] which notes that the OGC is currently reviewing value for money and rates of return the private sector gets on its investment in PFI projects to ascertain whether it is commensurate with the risks in undertaking government contracts: There is a risk that if a contractor builds high rates of return into the contract, it will be more expensive than if undertaken in the public sector. This is the argument put forward by Unison, which argues that PFI offers high profits for companies, and claims that AMEC expects an operating profits on PFI work of 15.8% and Serco an 8.9% profit rate (compared to 3.5% profit on its other activities).[59]. In contrast, the Public Accounts Committee notes that although the OGC do not know yet what level of returns would be highlighted by its study, shareholders' returns of 8 to 15% in real terms would be ‚reasonable' and that the OGC is also assessing whether returns are declining. Even in early PFI contracts (where the private sector tended to make more money) some private sector organisations had lost large amounts of money and the Chairman of the Major Contractors Group (which represents PFI companies) said that in his company, returns on PFI contracts were about 2.5% of turnover compared with 1% on other contracts. However the risks were significantly greater in PFI projects and there were high bidding costs.

High bidding costs and timescales are one of the main concerns the private sector has about PFI contracts: the others, according to the Confederation of British Industry are improving the management of risk; and raising public sector skill in managing long term contractual partnerships.

The private sector argues that bidding costs for PFI projects are significantly higher than when preparing bids for public services projects under conventionally tendered contracts. One reason for this is that the time taken between offering public service projects to the private sector and the final signing of the deal can be protracted. The average time taken to complete PFI deals in 2001 was estimated at 26 and 42 months for local government and NHS projects respectively.[60] Bidding costs can be disproportionately high when the PFI project is small scale. To address these concerns the Government introduced guidelines establishing greater standardisation of the tendering process in order to allow future PFI contracts across different public services to follow a consistent approach by incorporating standard conditions into all contracts

In its evidence to the Public Accounts Committee report, The Major Contractors Group was concerned about the time being taken to put contracts in place and had the impression that a lot of public sector organisations did not understand the importance of time to the private sector. The Chairman said that for one contract, valued at £70 million, which his company had bid for and won, there had been £4 million of bid costs at risk until the deal was signed. His company had also lost other PFI contract it had bid for after incurring costs of up to £1 million before being eliminated from the competition. Further there is a risk that high bidding costs could encourage contractors to discuss with each other their approach to bidding for PFI contracts.[61]

Last year it was reported that Amec, a leading PFI contractor, said it and other firms were considering abandoning the PFI because bidding costs are spiralling and there is a shortage of construction staff to cope with a „splurge“ in new capital projects. Amec's Chief Executive said he was perplexed and frustrated with a system where decisions on projects were delayed for years on time. The company is spending £5 million a year on bidding costs. Amec's statement was followed by one from the Major Contractors group which added that „the big problem is lack of skill in the public sector in dealing with PFI contracts“[62]

A recent controversy over profits relates to re-financing. The public sector has lost money from public managers failing to negotiate clauses in the original contracts whereby the public sector receives money back if the contractor subsequently refinances their borrowing. The refinancing issue was first highlighted by the Fazakerley prison scheme: the DBFO contract was awarded to a consortium formed by Group4 and Tarmac in 1999. The consortium delivered four months ahead of time, refinanced the project and increased its profits by £10.7 million (61%) but the Prison Service had not negotiated a share in any benefits from refinancing as part of its contractual rights. A National Audit Office report found that 61% of PFI contracts which had been let did not have contractual arrangements to share refinancing gains. Although it had been informed of 12 completed PFI refinancings from which departments had secured benefits of at least £17 million out of total gains of about £65 million, it also found evidence that some refinancings have taken place without departments being aware of it.[63] As a result the OGC has introduced a new code of practice which states that departments should generally receive a 30% share of future refinancing gains on the early deals, a code which has been supported by the CBI. As far as new PFI contracts are concerned, how to

[56] *Independent* October 31st, 2002
[57] House of Commons Public Accounts *Committee Private Finance Initiative: The redevlopment of MOD main building* HC 298 January 2003, para 3
[58] House of Commons Public Accounts Committee Managing the relationship to secure a successful partnership in PFI projects HC 460, para 11-12
[59] Unison *PFI:Failing our Future* September 2002, para 9.4
[60] House of Commons Research paper *The Private Finance Initiative* December 2001 01/117, pg 34
[61] House of Commons Public Accounts *Committee Managing the relationship to secure a successful partnership in PFI projects* HC 460, para 22-23
[62] *Independent* August 16th, 2002
[63] *PFI refinancing update* NAO November 2002 HC 1288, paras 8-9

negotiate refinancing formed an important part of the new OGC guidance on standardisation of contracts published in July 2002. This will ensure that in most cases gains arising from new contracts will in future be shared 50/50.

There has also been some controversy over the fact that the same people who write reports which state that PFI produces value for money have a vested interest in winning work from such deals. In the wake of the Enron collapse, Arthur Andersen was heavily criticised last year. Its report „Value for money drivers in the PFI" which was commissioned by the Treasury Taskforce in 2000 had produced a headline figure of 17% savings of PFI over conventional procurement. This figure was widely quoted in the UK debate as proof that PFI delivers value for money. But it is no longer used as proof of value for money, partly because of the awareness that Andersen was profiting from PFI. It was estimated that Andersen had been involved in £8.3 billion of Whitehall contracts and PricewaterhouseCoopers in £8.7 billion of contracts.[64] Unison claims that there were 45 PFI projects where the top five accountancy firms acted as advisers to the public authority and were also auditors to at least one consortium member or bidder for the same project.[65] Advisers can earn large sums in consultancy fees – for example, the projected consultant fees for the London Underground project are £150 million; the scale of these fees, it is argued, make it practically impossible that any of these companies will produce reports criticising PFI. In relation to this, the NAO are currently working on a report „The management of the PFI procurement process and use of professional advisers".

Conclusions

Problems and delays dominate the headlines in the PFI debate. But it should not be forgotten that the horror stories represent a minority of projects and that hundred of projects have proceeded without major problems. Moreover there has been a very steep learning curve, not surprisingly given that PFI is only a decade old. Yet the Labour Government is potentially vulnerable on the PPP/PFI issue: failure to make the intellectual case for partnership and as yet unproved value for money benefits leave a chink in their armour. This vulnerability is significantly increased by the Blair camp's tendency to take the involvement of the private sector into new areas, going past PPP/PFI and stepping into new territory. This could lead to disquiet within the parliamentary party and give an opportunity for Blair's opponents in government to score some points.

Further, key issues have been left unresolved: Most crucially, the two-tier workforce is still an issue. The Labour Government has clearly failed to carry the union movement with it. Although some members of party do not see this as a weakness, even welcoming an argument with the unions, the union campaign is surely a headache the Government could have done without and not something the German Government would want to replicate. Stronger signals that workforce concerns were important, plus proper and early consideration of the two-tier issue would have gone a long way towards stopping this problem before it started.

However, there is a clear perception in the party and a wider public view that PFI has created investment in essential services that would not have happened otherwise: despite official insistence that it is value for money that is the driving force behind the PFI, the clear implication in many political arguments is that it has created extra investment. Since the Government was elected on a commitment to improve public services, this can be seen as an advantage for them in positioning themselves as champions of good public services in a modern Britain. Against this is the mud it throws into the waters of making the intellectual case for PFI.

Probably the most crucial lesson that can be learnt from the UK experience is that proof of value for money is crucial: without this, the argument for PFI is severely weakened. Of one problem in proving value for money in the UK has been the controversy about the PSC, in particular the accusation that public sector managers feel that PFI is the only game in town and that projects will not get the go-ahead under a conventional procurement scheme. This relates back to the argument that the Government has not been clear in its rationale for PPP/PFI. Linked to this is the importance of regular independent assessments of PPP/PFI projects, for example through the National Audit Office. As has been seen in this report, one criticism in the UK is that there has not been enough independent assessment of projects.

Also fundamental is high level political leadership and a central organisation to promote PPP/PFI throughout Government and on all levels. UK experts stress that without a powerful sponsoring Minister in Government and a centralised Taskforce, the PFI deal flow in the UK would not have improved in the way it did after 1997. A Taskforce injects necessary private sector skills into the public sector and can work against the possible problems of public sector culture and lack of commercial skills amongst public sector managers. An important part of the Taskforce and Partnerships UK/Office for Government Commerce work has been the development of standardisation of contracts which can promote lower bidding costs, a speedier bidding process and, crucially, protect the public interest in case of problems (eg contract termination) or private sector success (eg refinancing).

To conclude, it is worth considering the wider political picture of the serious need for greater investment in public services. PPP has been controversial, but one might echo Tony Blair's conviction that the British public does not care who builds new schools and hospitals, as long as they are built. Scare stories about prisoners escaping from ‚private prisons' and sewage leaking into operation rooms in ‚private hospitals' are not as important as the perception that hospital and school building is going ahead and that much needed public services are being provided.

Appendix 1: Signed projects list October 2002

See Excel attachment

[64] *Independent* February 2nd, 2002

[65] Unison report *A web of private interest: How the Big Five accountancy firms influence and profit from privatisation policy* June 2002

Appendix 2: Regional breakdown of PFI projects

REGIONAL BREAKDOWN		
REGION	**NUMBER OF PROJECTS**	**CAPITAL VALUE (£M)**
EAST MIDLANDS	32	456.26
EAST OF ENGLAND	21	592.13
LONDON	68	4082.31
LONDON & SOUTH EAST	1	4178
NATIONAL	58	4374.66
NORTH EAST	19	623.39
NORTH EAST & NORTH WEST	1	9
NORTH EAST & YORKSHIRE & THE HUMBER	1	29
NORTH WEST	32	729.8
NORTHERN IRELAND	27	257.9
SCOTLAND	79	2118
SOUTH EAST	48	1235.53
SOUTH EAST & EASTERN	1	180
SOUTH EAST & WEST MIDLANDS	1	65
SOUTH WEST	37	1043.72
SOUTH WEST & NORTH WEST	1	18
SOTUH WEST & SOUTH EAST	1	72
WALES	30	561.6
WEST MIDLANDS	26	1422.26
WEST MIDLANDS & EAST MIDLANDS	1	21
YORKSHIRE & THE HUMBER	39	855.49
TOTAL	**524**	**22925.05**

Appendix 3: **Estimated payments under PFI contracts - April 2002 (signed deals)**

£ million			
2002-03	4 545	2015-16	3 940
2003-04	4 907	2016-17	3 943
2004-05	4 944	2017-18	3 898
2005-06	4 964	2018-19	3 071
2006-07	4 980	2019-20	3 323
2007-08	5 026	2020-21	3 434
2008-09	4 786	2021-22	2 923
2009-10	4 726	2022-23	3 013
2010-11	4 453	2023-24	2 982
2011-12	4 384	2024-25	2 995
2012-13	4 199	2025-26	2 708
2013-14	4 105	2026-27	940
2014-15	3 945	2027-28	617

Source: Financial Statement and Budget report 2002

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