The private finance initiative: the gift that goes on taking

Perfidious financial idiocy was how the BMJ’s editor described the private finance initiative (PFI) in 1999.1 Under the policy, NHS hospitals and land are sold off and new hospitals built using private loans instead of public loans or grants. We argued at the time that this would result in bed closures because hospitals had not been funded to pay the full costs of the loans, which are paid back over the 30-60 year contract period.2 3 And that’s what happened: English NHS hospital capacity fell by 73882 beds (almost a third) between 1992-3 and 2009-10, and occupancy rates rose to unsafe levels of more than 85% during the period when the PFI system of loan financing was introduced.4 5 In 2000, as controversy grew over PFI related bed reductions, the government’s National Bed Inquiry found that further acute sector closures were unlikely to be safely attainable without more intermediate and community service beds, and it recommended reversal of bed closures.4 The wasteful £6bn (£4.6bn; £6.3bn) independent sector treatment centre programme was introduced as a stop gap,1 and hospital reconfiguration continued.

Last week the Public Accounts Committee revealed that PFI is even less affordable.8 Banks lending to PFI projects have increased their interest rates by 20-30% since the financial crisis. But, as Audit Scotland has shown, private finance interest rates were already 2.5-4% above public borrowing rates before the government bailed out.9 Higher charges for interest rates mean higher annual repayments by the NHS, as much as £200m a year for every 0.01% to 0.3% increase in lending rate.10 The Public Accounts Committee calculates that the increased bank charges added £1 billion to the contract price, payable over 30 years, for the 35 projects financed in 2009.11

But the problem of higher interest rate charges is not confined to new PFI deals. The PFI’s annual charges rise each year because annual payments are linked to the retail price index. This policy requires large injections of taxpayers’ money to support it. The funding freeze and ring fenced PFI debt payments that are index linked provide the ingredients for a perfect economic storm.

The scale of the problem for the UK is formidable. By December 2009, 159 PFI projects, worth £13.2bn in terms of building costs, had been signed to the NHS, and total debt to be repaid had reached £4.3bn. This year alone (2010-11) all PFI payments across the public sector will reach £8.6bn. The commitment over the next 25 years is projected to be £210bn.8

What stands out is the disparity between the original cost of a building and the final bill—a consequence of higher interest and returns to investors. Is the bill worth it?

The government says it is. It argues that we are buying cost efficiency and that contractors have an incentive to be more efficient because it is their own money, not taxpayers’ money, that is at risk. According to the treasury, when “risk transfer” of this kind is taken into account, private finance is no more expensive than public finance.11

The UK parliament has repeatedly questioned the lack of evidence in support of risk transfer and value for money claims. In July 2010, a National Audit Office paper to a House of Lords committee described value for money as “subjective judgements of risk, which can easily be adjusted to show private finance as cheaper.”12 The chairman of the Public Accounts Committee described PFI as “probably the most secure projects to which the banks could lend.”12 The committee previously expressed concern over high interest rates, returns that contractors earn from PFI projects, and the risks they actually bear.13

To restore confidence in the financial markets and to free up lending, the UK government increased public borrowing to support the banking sector. It is this increased borrowing that lies behind the austerity drive across the public sector. In 2008-9, the government recapitalised the Royal Bank of Scotland Group (RBS) and the Lloyds Banking Group at a total cost of £37bn to become the major shareholder in both banks, holding 70% of RBS shares and 43.5% of Lloyds shares.14 The government also agreed to protect RBS from losses on risky assets up to £282bn.15 The effect of government rescue is to transfer the risks, completely or in part, from the private sector back to the taxpayer.

These same banks provide loans to and take equity shares...
in many PFI schemes; it is ironical that they are currently using high PFI interest rates to rebuild their balance sheet after the financial collapse. In other words, the public sector is making PFI payments to banks it partially owns, at a higher cost of borrowing than traditional public borrowing. This means that investment risks have now been transferred back to the tax paying public, negating the rationale for the policy. The rewards to PFI investors and shareholders are shrouded in secrecy, but an analysis of the financial projections for three hospital projects at the time the contracts were signed shows that pure equity investors are expected to receive £1.66m for £0.5m of equity invested in the Royal Infirmary of Edinburgh, equity of £100 in Hairmyres PFI hospital was expected to generate £89.14m for investors, and for Hereford hospital equity of £1,000 was expected to generate £55.7m. These high rewards are contractually protected and underwritten by government.

The genius of PFI is the way it diverts public resources from public to private interests, providing guaranteed profits to its backers in a time of austerity. But the shiny “new builds” will be cold comfort for the thousands of NHS staff now being served “at risk of redundancy notices” and millions of patients who face withdrawal of much needed entitlements and public services. A public enquiry and full publication of all contracts are long overdue.