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Ending the Secrecy of Public-Private Contracts: The hidden billions

by Oliver Huitson

The "public private" sector is estimated to cost the taxpayer over £80bn a year. The Private Finance Initiative (PFI) alone will see the public pay back over £260bn for buildings valued at just £60bn. We are facing unprecedented cuts to our public services, yet these contracts remain hidden behind a screen of "commercial confidentiality". It is time for the public to be given full access to the details of how money is spent through PFI by extending the Freedom of Information Act to encompass all contracts within the "public private" sector.

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Why now?

The public finances are facing cuts across the board which will translate to hundreds of thousands of job losses and widespread cuts to our public services. The BBC recently revealed the crippling effects that PFI will have on our health service as funding is cut but PFI payments will grow. The Coalition is keen to publish public sector contracts and salaries to encourage "restraint" and "accountability" but no mention has been made so far of the public-private contracts which amount to hundreds of billions of pounds. The release of MPs' data on expenses was similarly obstructed by all sides of the House and provides a key example of why suitable implementation of the FoI Act must be pushed from outside Westminster; there can be no accountability without transparency. The Coalition recently announced plans to extend the Freedom of Information (FoI) Act to cover "additional bodies" but refused to comment on whether this would include public-private contracts. Public pressure is essential to push for the inclusion of these contracts in any extension of the FoI Act.

How big is the public-private sector and why are these contracts kept hidden?

It is estimated that we currently pay over £80bn a year to private firms for public services. Most of the PFI contracts within that will take decades to repay. A large amount of public data is now available via the FoI Act, but there is a crucial exemption for public-private contracts under "commercial confidentiality". In 2009 the Labour government initiated a consultation to consider removing this exemption and allowing the public to scrutinise the State's contracts with private firms. After heavy industry lobbying the proposal was scrapped.

What is PFI and why is it a problem?

The Private Finance Initiative is often likened to spending with a credit card or a mortgage. Instead of the public sector funding the construction of new buildings, such as schools and hospitals, with PFI it is the private sector which constructs and maintains the buildings which are then leased back to the public, usually on a 30 year contract. PFI projects have often turned out to be wildly expensive, behind schedule and sub-standard on completion. Originally, PFI liabilities were kept off the balance sheet, allowing both Conservative and Labour governments to pursue large projects without due financial transparency: "Enron accounting".

Despite accounting changes to bring PFI liabilities into the public sector balance sheet, PFI projects have continued apace. Furthermore, there has been controversy over the business links between the ministers and civil servants responsible and the firms which have benefitted. PFI was described by Vince Cable, Business Secretary, as a "dishonest system of accounting, designed to hide taxpayers' liabilities."

Current PFI projects have provided buildings estimated at under £60bn in value. Over the coming decades the public will pay over £260bn for these buildings. And still the contracts remain private.

See the following table for a list of PFI projects and their estimated cost
(Source: Treasury, with columns CC, CD and CE added by OK showing total repayments, capital value, and % increase of repayments relative to capital value)

The official case for PFI

The Private Finance Initiative was first introduced to Britain by John Major's Conservative government in 1992. It was claimed that by using the private sector for public projects efficiency savings could be achieved whilst also transferring the risk to the private sector. When pubic funds were limited, it enabled successive governments to undertake large scale public construction projects to deliver buildings and services such as schools, hospitals and police stations. Without the use of PFI it is unlikely that the scale of new capital projects undertaken by the previous government would have been viable. This is the justification found in a 2001 House of Commons research paper on PFI:

"The PFI has meant that more capital projects have been undertaken for a given level of public expenditure and public service capital projects have been brought on stream earlier. As at 1 September 2001 there had been almost 450 PFI deals signed with a total capital value of £20 billion."

In contrast to standard public procurement, PFI sees private firms, or private consortiums, raising the finance and constructing the buildings. This allows the government to lease the services, typically on 30 year contracts, and so avoids the need for the public sector to raise the necessary capital itself. The efficiency of the private sector would supposedly see delivery times met, costs kept to a minimum and keep public sector borrowing to manageable levels. This view was supported by the National Audit Office in 2003 who claimed PFI did indeed represent good value for money. Both the Conservatives and Labour have promoted and used PFI whilst in office. The present Coalition government has continued this trend; Chancellor George Osborne has already signed off his first PFI scheme.

When PFI goes wrong

Despite the litany of practical failings, there are serious flaws in PFI even from a theoretical standpoint; it is from these failings, rather than public sector naivety, that PFI has so often proved excessively expensive. The funding model, at core, sees the private sector raising the finance for the buildings which are then leased back by the public sector on long term contracts. The public sector will always be able to raise finance at much lower rates than any private sector conglomerate. The additional costs of private financing are, like everything else, passed on to the taxpayer.

On the issue of value, the key claim of PFI proponents is that the private sector is more efficient than the public; it will drive down costs. This may be true, but what also must be considered is the private sector is, under legal statute, a profit maximising entity – they are not *cost minimisers*. Savings from efficiencies are often offset by the profit margins required for private investment (in one instance a return of 662% was made, see below). For overall value, the profit margins must be no higher than the efficiency savings made. This requirement is regularly missed not just in relation to PFI but to the "public private sector" in general.

The legal fees involved in the PFI process are substantial. The negotiation of contracts is a lengthy and hardly contested area; the legal services required to commit large sums of public money to 30 year contracts are extensive and costly. These additional costs, like profit margins, must be exceeded by private efficiency savings to deliver overall benefit to the taxpayer.

The public sector has, by its own admission, regularly been outmanoeuvred in its contractual dealings with PFI providers. With each new scandal comes the latest rendition of PFI's traditional defence – 'we'll get it right next time'. Yet still, as the MoD example below shows, the state does not get it right. Questions must be raised about any procurement scheme of a complexity such that after nearly two decades of practice, highly trained civil servants are still regularly unable to protect the taxpayer from exploitative levels of cost and error.

Refinancing is a perfect example of the problems in question. When finance is initially raised prior to construction, the risk to the lender is comparatively high. This is reflected in a higher cost of finance, a cost which is included in the price of the public's contract. After initial stages of construction have been completed the risk is further reduced, allowing the private firm to refinance the loan at much lower rates. This is exactly what many firms involved with PFI have done, landing them many millions of pounds in windfall profits purely by refinancing their loan (the contractors behind the Norfolk and Norwich University Hospital made windfall profits of £95million by refinancing, see below).

PFI's failings cannot be entirely laid at the feet of civil servants. There are serious conceptual flaws, from the public's perspective at least, that need to be addressed.

PFI in practice

The following provide just some examples of how works PFI in practice.

Ministry of Defence tanker project

"A £10bn defence deal turned into a "bureaucratic nightmare" after the government insisted on using private finance to keep the cost off the national balance sheet, according to a highly critical National Audit Office report out today."

"'Because the contract was shrouded in secrecy, it is only now that we learn that the planes will not even be fitted with defensive aids to enable them to fly into war zones.' He described it as 'one of the most absurd procurement decisions taken by this Labour government'.

Source: The Guardian.

The Skye Bridge

"The bridge, in other words, appears to have cost the public £93.6m. If we accept the consortium's account of how much it cost to build - £25m - we have paid for it 3.7 times. Even this could be an underestimate: independent engineers suggest that it shouldn't have cost more than £15m.

So what was in the contract? I have no idea, and nor does anyone who was not involved in negotiating it. Though it was giving away our money"

Source: The Guardian.

NHS projects

"The BBC reports today that due to some cunningly engineered PFI contracts, the health service in England will end up paying £65bn to private contractors for hospital building.
This figure is shocking, given that the actual value on completion of the 103 hospitals was just £11.3bn. This means that, in effect, private companies are charging the state a premium of more than £50bn for building and mainaining these hospitals."

Source: New Statesman.

Argyll and Bute Council school project

“Nearly £20m will leave cash-strapped Argyll and Bute this financial year in PFI repayments, with over £8m of that in INTEREST alone.

Argyll and Bute Council will, over the 30-year life of the agreement to build five new schools (including Dunoon Grammar School), pay £370.885m – for buildings worth £87.573m.”

Source: Dunoon Observer.

North Wiltshire Council Property Portfolio project

“New figures released yesterday showed that in one case, Jarvis had a staggering 662% return on a tiny £10m scheme to rationalise the property portfolio of North Wiltshire council.”

Source: The Guardian.

House of Lords economic affairs committee

“The House of Lords economic affairs committee condemned ministers for keeping two sets of departmental books, saying it had helped to obscure the hidden, long-term costs of private finance projects (PFPs), such as those used to build hospitals and schools.

While critics of PFPs often claim they are a device to place public-sector spending "off the balance sheet", the committee said between £170m and £410m from the public purse had been lost from the collapse of Metronet Rail, the public-private partnership which held a contract to maintain, renew, and upgrade the infrastructure on nine London Underground lines.”

Source: The Independent.

The Widening of the M25

“In April, the widening of four sections of the M25 was to have cost you and me £5bn. This was already a spectacular rip-off. The Campaign for Better Transport had calculated that the same amount of extra road space - if it were really needed - could have been created for £478m(1). But somehow, over the past four weeks, the £5bn for widening four sections of motorway has mutated into £6.2bn for widening two(2). In Sicily, officials agree to terms like this with the help of dainty gifts like horse’s heads and waistcoats full of fish. In the UK, the government volunteers them without any obvious inducement.”

Source: The Guardian.

Spiralling Costs

“The majority of signed-off housing public finance initiative projects have suffered significant cost increases and all have been delayed, according to a National Audit Office report.
The report, which criticises the Communities and Local Government department for failing to assess projects for value for money, found 21 out of 25 schemes required significant extra government funding prior to contract signature.

A total of 12 schemes saw cost increases above estimates in the initial business cases of more than 100 per cent."

Source: [Inside Housing](#).

Norfolk and Norwich University Hospital

"The £95 million that private companies extracted from a hospital project was not a mistake, but a deliberate gift from the government."

Source: [The Guardian](#).

Maintenance Contracts – how a light bulb costs us £333

Though varying from scheme to scheme, under most PFI contracts the maintenance of the building is included as part of the agreement. Because the private firm (or consortium) owns the buildings in question, they both manage the maintenance as well as dictating its costs. Exorbitant fees for the changing of light bulbs, posters and toilet rolls are seemingly commonplace. This is a further area of PFI that appears to suffer from some highly questionable practices yet the contracts in question are still unavailable to the public.

Police hotline for toilet roll changes

"Kent Police's state-of-the-art £23million Medway Headquarters in Gillingham and the £31million North Kent police station in Gravesend were constructed under private finance initiatives.
The deals mean maintenance contracts for both are handled by a private contractor. As a result, frustrated officers have to send off request forms or call a 24-hour hotline for everyday supplies including toilet rolls, lightbulbs and cutlery."

"According to Police Review, they must also call the hotline if they want to put up crime prevention posters or reposition plants and litter bins."

Source: [The Daily Mail](#).

£333 to change a light bulb

"Modern NHS hospitals built under controversial private finance initiatives could be forced to close wards or shut down entirely, an expert has warned."

"The Dispatches programme also found that a multi-million pound contract to build and run the Nome Office's new headquarters building had been shifted to a tax haven."
"And a health pressure group reported that companies involved with NHS PFI projects stood to make windfall profits of £3.3 billion."

"As part of a six-month investigation, Dispatches also found one hospital was being charged £333 pounds by the firm running it for changing a lightbulb."

Source: [The Daily Mail](#).

Business links between ministers, civil servants and the private sector

There is a well-trodden path between government and the civil service and some of the companies that stand to benefit from PFI.

Alan Milburn, Health Secretary from 1998 to 2003

Listed as director of Covidien, “a $10bn global healthcare products leader”, in 2009. He is also a member of Lloydspharmacy’s Healthcare Advisory Panel as well as an advisor to private equity firm Bridgepoint, the healthcare specialists.

Source: They Work For You.

Charles Clarke, Education Secretary from 2002 to 2004 Home Secretary from 2004 to 2006

Non-executive director of the LJ Group, a supplier of equipment to schools. In addition, Clarke is a consultant to Beachcroft LLP, a legal firm that specialises in advising PFI/PPP deals.

Source: They Work For You
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Patricia Hewitt, Health Secretary from 2005 to 2007

Adviser to Cinven, a private equity-backed private hospitals and healthcare group. She is also special consultant to AllianceBoots, which is owned by private equity firm KKR. In addition, Hewitt was a director of BT Group, providing business outsourcing, IT and telecoms services to a range of public bodies.

Source: They Work For You.

David Blunkett, Home Secretary from 2001 to 2004 Education Secretary from 1997 to 2001 and Work and Pensions secretary in 2005

David Blunkett is now an advisor on business development to A4e Ltd, for which he is entitled to be paid at least £25,000 a year, but which (according to his Parliamentary declaration of interests) he has not yet been paid. A4e describes itself as a “market leader in global public service reform”.

Source: They Work For You.

Lord Warner, Health Minister from 2003 to 2007

Lord Warner had specific responsibility for reform of the NHS – overseeing the introduction of more private sector involvement. Since he stepped down from that role he has taken on a directorship with UK HealthGateway and is chairman of the Government Sector Advisory Panel for Xansa plc – a leading provider of business outsource services to public bodies and holder of the £1bn NHS's shared business service centre contract, providing accounting and finance services to the NHS.

Source: The Times, Parliament.uk

Nick Raynsford, a Local Government and Housing minister from 1997 to 2005

Nick Raynsford is now non-executive chairman of local authority recruitment agency Rockpools PLC and of Hometrack, a lettings service. He is also honourary vice-chairman of the Construction Industry Council, as well as chairman of the NHBC Foundation.

Source: They Work For You

Ian McCartney, Trade Minister from 1997 to 1999 and again from 2006 to 2007

Ian McCartney is a senior adviser to the US Fluor Corporation, an energy contractor closely associated with the nuclear industry. The former Department of Trade and Industry had responsibility for energy policy.

Source: They Work For You

Stephen Byers, Trade and industry secretary from 1998 to 2001

Stephen Byers is now non-executive chairman of water treatment company ACWA and Chairman of Yalta European Strategy Ltd.

Source: They Work For You

Richard Caborn, Trade minister from 1999 to 2001

Richard Caborn is now a consultant to AMEC assisting them with their work in the nuclear industry. He is also a non-executive director at Nuclear Management Partners, as well as a consultant to the Fitness Industry Association.

Source: They Work For You.

Stephen Ladyman transport minister from 2005 to 2007

Stephen Ladyman is now an adviser to ITIS Holdings, a company selling traffic information, for which he is paid at least £10,000 a year.

Source: They Work For You.

Sir Steve Robson

Sir Steve Robson oversaw the privatisation of British Rail under John Major and was often referred to as Labour's privatisation "guru". After leaving office, he became a non-executive director at Cazenove, Royal Bank of Scotland, the mining firm Xstrata and Partnerships UK (PUK). At PUK he is officially the "treasury nominee" although his bank, RBS, is one of the biggest beneficiaries of PFI.

Source: Private Eye, March – April, 2004.

Bill Moyes, **former assistant secretary in charge of development**

Was seconded from the civil service to the British Linen Bank, a subsidiary of the Bank of Scotland. In November 1996 he became a full-time executive director of the British Linen Bank. In January 1997, when the successful consortium bidding for the Stonehaven hospital contract was named, it included… the British Linen bank.

Source: Private Eye, March – April, 2004.

European PFI – learning from our mistakes

Between 2001-2008, the UK invested more in PPP (public private partnerships) schemes than the rest of Europe combined, £61bn to £37bn respectively. Where most European countries employed PFI for smaller scale and specific types of project, the UK adopted a "PFI or bust" approach; it became the default model for public procurement.

Value of signed contracts, €m

	2001-04	2005	2006	2007	2008	Total	*Number signed deals 2001-08*	Projects being procured Jan 2007 €m
Spain	1000	1154	1664	309	---	4127	*38*	2931
France	---	1788	735	329	1241	4093	*34*	3964
Italy	890	2179	439	55	---	3563	*20*	29799
Ireland	720	121	623	1489	300	3253	*19*	---
Greece	---	798	1600	3885	1000	2398	*8*	6270
Germany	440	830	177	465	117	2029	*40*	9495
Belgium	1300	480	---	300	680	1780	*6*	3635
Netherlands	1302	---	431	---	1020	1733	*9*	1211
Poland	1520	---	---	---	---	1520	*2*	1317
Austria	49	---	850	---	---	899	*6*	20
Finland	---	700	---	---	---	700	*1*	---
Bulgaria	---	366	288	366	---	654	*6*	2202
Hungary	---	---	38	15	500	556	*11*	264
Cyprus	---	500	---	---	---	500	*1*	---
Portugal	278	---	32	140	---	450	*7*	1515
Other countries	485	2	490	---	---	977	*7*	4957
Total (exc.UK)	**7987**	**8918**	**7367**	**7353**	**4958**	**36583**	***215***	**67580**
UK	21849	6237	14111	10698	8236	61131	*536*	

Source: Public Private Finance, DLA Piper

(Source: IFSL Research, PFI in the UK & PPP in Europe 2009)

The Dutch approach

The Netherland's measured approach to PFI makes for interesting reading. Crucially, the Dutch procurement process insists on no more than 50% of the finance being raised privately, the remainder is raised by the state in the orthodox manner**.** The Dutch government have observed and investigated the UK experience where up to 90% of project costs have been raised privately and concluded that such a split represents an unacceptable risk both to ownership and value for money. Furthermore, in contrast to the 30 year contracts routinely adopted in the UK, the Netherlands uses short term, 4 year contracts, allowing far greater flexibility and securing much better value for money. Between 2001 and 2008, the Netherlands signed 9 PPP contracts, the UK signed 536.

As a result of this procurement process and the lower profit margins emanating from short term contracts, international finance has not been attracted to Dutch PFI and almost all projects have been won by Dutch companies. This has proved beneficial for the Dutch economy as public control, in terms of company taxes and corporate responsibility, has been effectively maintained.

Though the Dutch have been reluctant to use PPPs for anything other than small, short term projects, they did experiment with a larger scheme to provide the *HSL Zuid* rail link between Amsterdam and Antwerp. This was the largest PPP contract ever awarded by the Dutch government, agreed with the PFI firm *Infraspeed* on a 30 year contract. The project was the closest the Dutch came to the British model of PPP procurement.

The rail link was supposed to be completed by September ’07, linking Amsterdam to Paris in under 3 hours. It eventually opened in December ’09, with a limited service and not reaching the full speed until earlier this year. The Dutch Audit Commission (Algemene Rekenkamer) criticised the public operator, *Rijkswaterstaat* (State Water Company), for guaranteeing all the financial risk of project delays and questioned the ability of the Dutch public sector to implement PPP's of this size.

The eventual findings were that PPP on this scale should not be undertaken again in the Netherlands. In the UK, such delays, over-spends and inappropriate risk management have been all too normal. Far from rejecting PPPs as suitable models for large scale public procurement, the UK is still signing off new PFI schemes; the Coalition government has already signed off its first. And still the contracts under which these schemes operate are entirely unavailable for public scrutiny. Under Dutch law, any citizen may request access to PPP contracts. Such requests must be answered within 14 days. Though grounds for exemption exist, the burden falls on the government or contractor to prove the case for exemption in each case (Dutch Freedom of Information Act, *Wet openbaarheid van bestuur* link - 3).

Looking forward

Labour’s legacy

With a newly appointed leader, the Labour party needs to acknowledge the PFI legacy that it has left not just to current voters but also to future generations; a number of PFI contracts will run until the middle of the century amidst tightly contracting fiscal conditions. Private finance was pursued with dogmatic fervour even in the face of serious concerns arising, “its PFI or bust”.

> *An even more significant figure who did not care to engage in a serious discussion of the issues was the Chancellor of the Exchequer, Gordon Brown [subsequently Prime*

Minister of the United Kingdom]. In 2002 I asked him if he could explain the rationale behind the use of private finance for public investment, given that private borrowing was more expensive, and the risks were not in practice transferred to the private sector. His response was simply to declare repeatedly that the public sector is bad at management, and that only the private sector is efficient and can manage services well.

(Allyson Pollock, *NHS Plc: The Privatisation of Our Health Care, 2005, p3*)

PFI was a defining feature of New Labour's embrace of the market. For Ed Miliband to make any credible claims of a break with New Labour ideology, the toxic legacy of private finance must be acknowledged.

The Coalition and PFI

In opposition, Chancellor George Osborne readily admitted the need for PFI to be re-examined. Speaking in 2009, he criticised PFI as "flawed" and in need of "replacement". Announcing the creation of the new Office for Budget Responsibility, he declared PFI to be one of the areas that the new body would be reviewing. The Commons Public Accounts Committee also recognised the dangers of unaccountable PFI spending in 2008, warning that,

…*claims of commercial confidentiality were making it difficult for MPs to scrutinise the growing number of PFI contracts and other outsourced deals.* (FT, September 2, 2008)

However, Osborne was recently presented with two very similar proposals for new hospitals, one in Hartlepool and one in Merseyside. One important difference was in the funding model proposed. The Hartlepool scheme was to be mainly funded publicly, whereas the Merseyside scheme was structured as a traditional PFI arrangement. Sadly, it was the latter that was approved.

Both the Conservatives and Labour have identified the serious failings of PFI whilst in opposition, what remains to be seen is whether the Coalition is prepared to act on the issue in government. The merits of PFI are worthy of serious debate, but at the very least the Coalition must make public the contracts under which the schemes are being run. Fears that the Coalition "transparency" theme is ideologically targeted towards the BBC and public sector will only be heightened without a firm commitment to genuine transparency; that must include PFI.

Report by Oliver Huitson for openDemocracy's OurKingdom, with translation by Justin Hughes.