PFI THE MOUNTING COST.

£65BN "NHS MORTGAGE" IS ONLY THE TIP OF A £230BN PFI ICEBERG, WARNS GMB

GMB warned today that BBC figures showing a £65bn bill for hospitals built under the private finance initiative (PFI) was only the tip of a £230bn PFI iceberg looming across the public sector.

The long term involvement of the private sector in the delivery of public sector assets has not brought about the claimed benefits of transferring risk from the public to the private sector nor has it delivered long-term value for money, which is crucial. The high costs of the Private Finance Initiative (PFI), which typically escalates over time and the poor quality of services it provides, are having a knock-on effect on huge areas of the government's policy and on its efforts to contain costs and improve the quality of public services.

The time has come to end private finance initiatives as a way of financing public sector assets, and return to more conventional models of procurement, which are less expensive, more flexible, and can be better managed to accommodate changing public service needs over time. Our view is backed by a growing body of evidence which indicate that private finance is inherently more expensive than government borrowing; projects tend to be slow, are hugely complex, and are prone to escalations both in scale and cost, and lock the public sector into protracted and inflexible contracts of typically 30 years.

Last year, the Health Secretary, Andrew Lansley MP, warned that the rising costs of paying for hospitals under PFI is bringing the NHS to the "brink of financial collapse" and putting patient care at risk. He said that 22 Health Trusts were struggling financially to cope with the high costs of PFI. And in February 2012, Mr Lansley has admitted that seven Health Trusts which run 21 PFI hospitals between them will have to be bailed out at a cost of £1.5m each because they are struggling to meet high PFI payments, and as such are at "severe risk" of failing patients.

The rising cost of over 650 PFI projects hit £230bn this summer and won't be fully paid off until 2048, according to a new GMB analysis of the latest Treasury data.

The debt mountain will grow further, as private contractors demand above-inflation returns. The National Audit Office and the Commons Public Accounts Committee have found price hikes of up to 14%.

Including the £44bn already handed over for PFI schemes up to 2009-10, the public purse will be hit with a total PFI bill of more than £270bn which is almost five times the value of the assets built (£56bn).

It means that British PFI debt is now equivalent to £9,300 per taxpayer. Annual payments are forecast to break the £10bn mark by 2017-18.

Under PFI, money for new public assets such as schools and hospitals is raised by private consortia instead of the public sector.

Private companies design and construct the buildings and then lease them back to the public sector. They also add in charges for service provision, such as maintenance, catering and cleaning.

Public agencies pay an annual sum to the private consortia for the lifetime of the contract, which can last as long as 35 years.

PFI costs are higher than normal public finance. Private firms cannot raise funds as cheaply as the Government, and tighter credit conditions have increased the cost of private-sector borrowing.

The Use of PFI must be compared to conventional methods of procurement in reality there have been cost issues in the past but many of the advantages have been over looked.

Private finance schemes should be compared with a public sector comparator (PSC) to ascertain value for money. But the methodology is flawed as it is heavily subjective and depends on assumptions that are built into the process, many of which favour PFI. For example, assumptions on time and cost overruns built in to optimism bias calculations and assumptions on taxation. The system is therefore more open to manipulation, bearing in mind that currently there are very few “real" alternatives to PFI for major investment. Indeed, the evidence to date suggests that many public bodies are compelled to sign up to PFI if they want to undertake large capital projects because of the limited funding options available. In many instances public authorities are incentivised to use PFI, with PFI becoming “the only game in town”.

Conventional models of procurement – mainly design and build contracts, which are publicly financed – are more efficient and effective and less costly than private finance schemes where projects are prone to escalations both in scale and cost at the preferred bidder negotiations stage before final contract signing. It is still possible to have fixed price contracts (often at a premium) during conventional procurement so as to transfer risk to contractors for cost over runs.

Conventional procurement is more flexible, as contracts for facilities management tend to be shorter and not as rigid and protracted as is the case with private finance schemes. If service delivery models change then they are less costly to downsize or renovate the buildings too.

Conventional procurement allows for greater autonomy, transparency, scrutiny and accountability in managing contracts. They allow for flexibility in the planning and delivery of public services, and in dealing with unexpected situations such as a rise in the number of emergency admissions or an increase in demand for health services. On the contrary the long-term nature of PFI contracts tend to lead to loss of accountability and flexibility.

A major justification for PFI is that risk is transferred to the private sector. But in practice, most risks are borne by the public sector. Indeed the private sector takes on some risk for cost and time overruns, but the more fundamental risks of failure stay with the public sector. For example, the public sector retains demand risk, the number of patients or prisoners or pupils – with the result that if demand changes, the public sector picks up the bill. The public sector also picks up the bill when contracts go wrong.

To continue along these lines is madness. As the buildings deteriorate and technology improves there will be significant detachment from the aims of the original contract. Many hospital buildings built only a couple of decades ago have been replaced by PFI constructions. With contracts running to 2048 public expectation for value for money will increase. Pressure will mount on the public purse to make the necessary changes to modernise the NHS. With little or no flexibility, the risks will transfer back to government with the possibility of the contractors walking away without any responsibility for the mess that they leave.

GMB National Secretary for Public Services Brian Strutton said: “This research shows what a terrible deal PFI is for the taxpayer. Rising debt levels are forcing hard-hit public agencies to cut services to save money. Exorbitant costs are creating a PFI future funding black hole of £230bn, on top of the £44bn already paid, that many hospital trusts and other public bodies are already finding impossible to fill”

The conclusions are worrying for both employees, who work for PFI schemes and public bodies who have large PFI investments. Sooner or later the pressure will arise for new investment. Paying off the NHS mortgage will be necessary to enable the flexibility for new investment. This is going to be a major political issue as time elapses. The questions for all concerned are is there a political will to defuse this financial time bomb, what state will public finances be in and who will pick up the bill?

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