Seize the Initiative

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The purpose of the Initiative

In the lively debate about the merits and future of the Private Finance Initiative (PFI), it is easy to lose sight of why the Initiative exists at all.

PFI was introduced to solve a fundamental problem that has beset governments, and not just British ones, for decades. Since the annual revenues of any government are limited, large–scale public sector projects have to compete for scarce funds. Very desirable projects may be rejected simply because not enough money is expected to come into the Treasury that year: and they have to wait in line until enough can be diverted from current tax receipts to pay for them.

This is hardly a rational way of financing large–scale capital projects, and it has had several undesirable results.

First, infrastructure investment has been inadequate as governments could only afford to have a handful of large projects underway at any one time. Indeed, this was one of the main reasons for privatization — it was the only way that state enterprises could make the investments they needed to be competitive, or to meet new legal standards, as with water and sewerage.

Second, it encouraged a pattern of *ad hoc*, piecemeal investments that were typically shorter in term and smaller in scale than the optimum, since only the smaller and cheaper projects could be squeezed through the annual public spending limits. Instead of comprehensive programmes to enhance road and rail networks, for example, it was possible to make improvements only a link at a time. Though the expenditure may carry on for years, the benefits would start to appear only when the last link was finally in place.

Third, to make projects cheap enough to get through the annual bidding round, money was skimped on the initial design and building stage. This produced public buildings that were inadequate to their purpose, built cheaply with little regard to the full–life costs and higher maintenance and refurbishment costs that would have to be borne in future years. The poor state of our postwar schools and housing estates are prime examples.

The PFI was introduced in order to remedy these problems. By then (Autumn 1992) it had become glaringly obvious that the pressure to keep taxation, borrowing, and public expenditure under control could not be reconciled with the obvious needs and demands for substantial public capital investment, particularly in infrastructure and the NHS.

The ultimate test of the Initiative is whether it solves the problems of the traditional method of public procurement and does so in such a way as to deliver better, more efficient public services while reducing the total burden on the taxpayer.

The prize of PFI

In fact, the Private Finance Initiative is the latest in a series of programmes designed to introduce commercial disciplines and private sector finance and management expertise into the public sector. It has typically been associated with the construction of large–scale infrastructure projects but increasingly it is being seen as a way of financing and providing smaller projects, including prisons, hospital facilities, and information technology services.

The government has set ambitious targets for PFI. It expects capital spending under the Initiative to be around £2 billion per year and to rise over the next three years. More than 1400 projects, worth an estimated £25 billion, have been identified.[1] Well over 100 of these are now in procurement,[2] and the aim is to have contracts worth at least £14 billion agreed by the end of 1998–9.

The full potential is even larger. Michael Jack MP, Financial Secretary to the Treasury, estimated recently that over £50bn of potential business is being explored by government and local authorities,[3] and he reported that savings of 7% are already being achieved on capital projects procured through PFI. The Chancellor, Kenneth Clarke MP, went on to report that more than 6000 companies had registered an interest in doing PFI work,[4] underscoring his earlier prediction that "before many years, private finance will be the usual way of meeting the government's capital spending requirements".[5]

However, it remains to be seen whether all these projects are feasible or indeed desirable. The overwhelming view of 200 companies surveyed in the June 1996 *Contract Journal* and consultant James R Knowles was that the government would fall 40% short of its £14 billion target, thanks to the high costs, over–complexity, and unpredictable tender processes in PFI work.[6] Given that the Initiative has been running since Autumn 1992, some critics regard the fact that only 100 out of a possible 1400 projects are now in procurement is no great sign of success.

The stakes are high. The PFI is vitally important because it holds out the promise of providing additional and much–needed capital expenditure in the public sector by harnessing private sector finance and management expertise to deliver better value for money and better quality services. Or in the more circuitous words of the Treasury Committee: "PFI...[is] an imaginative and very laudable initiative to attract private capital into areas into which it has not been previously drawn, and ...to introduce into investment appraisal and project management in the public sector more effective techniques and disciplines".[7]

There is a strong consensus that the PFI could and should deliver this prize. The main questions are whether it can do so in its current form; and if not, whether it can be made simpler, quicker, cheaper, and otherwise improved enough to restore the confidence of the potential private sector bidders.

Many firms, and not just those who have been unsuccessful in obtaining PFI contracts, report themselves disillusioned and frustrated by the whole process. When the companies pursuing a typical PFI project can expect to spend upwards of £2 million between them just to prepare their bids, even those who retain a positive outlook have become highly selective.

Thus it came as a shock to many commentators when John Laing, a major construction company, withdrew from a prominent PFI hospital project, and another, Bovis, withdrew from PFI roadbuilding. Both are still actively involved elsewhere; but when the initial costs are so high, not even the largest contractors can be expected to pursue every opportunity that comes along. Quite naturally they will focus on those few projects where they see the greatest chance of success.

The complexities, delays, and mistakes in the tendering process keep the costs of PFI high and the chances of success slim. Yet politicians and officials seem unaware of just how much this inhibits potential contractors from participating widely in the process. Reform is needed if the patience and goodwill of the private sector is not to be strained further.

The success of PFI depends on retaining that goodwill. Failure would have serious political ramifications beyond the economic issues of how capital projects are provided. For the Conservatives, the failure of PFI would reveal their inability to make their faith in private sector expertise and financial management work at the heart of the public sector. For Labour, it would undermine the prospects for developing public–private partnerships that have been a favoured theme of theirs for some time.

It would seem that all sides — public, private, left and right — have much to gain by getting to grips with the core problems of the PFI and pushing forward the reforms needed to “win back the Initiative”.

Origins of the Initiative

Although the PFI was officially launched in 1992, its origins lie in a 1981 report produced by a committee set up by the Treasury under the chairmanship of Sir William Ryrie. It established two main principles for the use of private funds in public sector capital projects, known as the Ryrie rules.

The first rule was that schemes for using private funds should be tested against publicly funded alternatives and allowed to proceed only if proved to be more cost–effective.

The second rule was that such schemes should not occur as additions to planned public sector schemes, unless Ministers decided otherwise in particular cases. This meant that public expenditure should thus be reduced by the level of private finance obtained for a planned public sector project.

Under these rules, a few privately funded capital projects went ahead, including a third crossing of the Thames at Dartford and the second Severn crossing. (The PFI's origins in large infrastructure projects where there is very limited scope for service innovation — are still felt in the predominant public sector view of the role of PFI, which is for the private sector to do what the public sector would do if only it had the money).

In 1989, this second rule was relaxed by John Major MP, then Chief Secretary to the Treasury, so that such projects no longer had to be substitutional.

Then in November 1992, Norman Lamont MP, the Chancellor of the day, abolished the first rule for self–financing projects, and announced that in future the government would actively seek private sector finance for public projects and would no longer test them against publicly funded projects. Testing against a public sector alternative is not required where a project involves no public money or would not have gone ahead unless it was privately financed. The competitive process between private sector bidders is assumed to be a sufficient test for ensuring value for money.[8]

In the 1992 Autumn Statement, Norman Lamont MP officially launched the PFI. This marked the beginning of PFI as a means by which all sorts of public sector projects, not just infrastructure plans, could be funded using private finance and private sector input throughout the process.

The current official position is that all public sector bodies should now consider PFI strategies when business strategies and efficiency plans are being drawn up, when the refurbishment of or acquisition of a capital asset is foreseen or being considered, and when the future of a public body is under consideration. However, this is not an unalloyed blessing; while it increases the number of potential PFI projects in circulation, it often means that the strategy is being tested in areas for which it is actually inappropriate, causing delay, cost, and confusion in the procurement process.

The panel and the executive

To promote wider participation in and understanding of the PFI, both inside the public sector and in the private sector, the Private Finance Panel was established, initially under the chairmanship of Sir Alistair Morton, then under Sir Christopher Bland.

The third and present chairman, Alastair Ross Goobey, describes the panel as "an independent and non–executive, but powerful, board of volunteers controlling a 24–strong executive" in the Treasury. He continues:

> "The panel, which has on it people who all have a vested interest in the success of introducing private capital to public services, cannot discuss the details of individual contract negotiations. What we can do is to listen to participants, chivvy departments and politicians, keep a strong executive and disseminate the lessons learned."[9]

2. The nature of the Initiative

It is perhaps misleading to talk about "PFI" when there are many types of PFI projects, using quite different types of financial arrangement, ranging in value up to many hundreds of millions of pounds. However, what they all have in common is the use of private sector finance and management to facilitate public sector capital projects. The Chancellor Kenneth Clarke described PFI thus:

> "Under the Private Finance Initiative the public sector does not simply sign a contract to buy a prison, a train or a computer system. It pays to have specific services supplied at guaranteed levels of performance — available prison places, trains running reliably on the Northern Line, national insurance records kept up to date. The government chooses the quality services the public require, and then goes out and acquires those services from private companies with the finance and expertise to deliver."[10]

Types of PFI contracts

It is important to distinguish between different types of PFI contracts and the manner in which they are financed. There are three main types of PFI contract:[11]

1. Design, build, finance and operate (DBFO)

This is an agreement between the government and a private company to develop a project from scratch. The contracts tend to be long term so as to allow the contractor to generate a revenue stream sufficient to cover capital and operating costs. At the end of the concessionary period the assets are (usually) transferred to the Secretary of State. If direct revenue collection is not possible, the contractor is remunerated by the government on the basis of usage and other performance targets.

2. Design, Build, finance and operate (BDOM)

These contracts tend to be signed when the private sector partner is used in what is essentially a public sector project. The majority of the finance comes from public sources, while the private sector is required to develop the project and eventually be responsible for its operation. Revenue accrues to the private company, which is typically a joint private–public venture.

3. Build, own, operate and transfer (BOOT)

These contracts are used for financially free–standing projects, where it is possible for the private company to charge for the use of the services it provides. Contracts are for a specified concessionary period, considered to be sufficient to recover construction and operating costs, plus a return on capital.

Types of PFI finance

Within these contracts, PFI projects utilise private finance in one of three ways:

1. Private finance only, recovered through direct charges to the end user

These are financially free–standing projects — where a private company provides and then owns an asset, and recovers its costs wholly through charges to the final users. The public sector is involved only to the extent of enabling the project — e.g. awarding planning permission, any necessary licences, and so forth. Examples of this are car parks, toll bridges, and projects like the Channel Tunnel. Often, as with the Dartford Bridge, there is a provision for the asset to pass into public ownership after a concession period, during which the providing company has recovered its costs and had the chance to make an acceptable level of profit.

2. Private finance only, but recovered through charges to the public sector client

These schemes are in effect services provided by the private sector and 'sold' to the public sector. A private company provides an asset, the use of which is then sold to the public body that enabled the project. Examples of this are privately built prisons like those as Fazakerley and Bridgend, and trains for the Northern Line. Other examples are the £150 million outsourcing of information technology provision by the Department of Social Security.

3. Private and public finance

These are joint ventures whereby a project is funded partly by the public sector and partly by the private sector, though with private control and ownership of the asset provided. Public sector contributions can be in the form of grants, loans, equity and financial guarantees, through the provision of assets, such as land, or by providing employees' time in the planning stages or during feasibility studies. Examples of this are the Channel Tunnel Rail Link and the Croydon Tramlink.

The application of PFI

PFI is being used in a diverse range of departments and in a number of different areas: transport, health, prisons, defence, accommodation (central government property), urban regeneration, information systems, higher and further education, water and sewerage. However, PFI has been most visible in the first three areas: transport, health and prisons. It is these areas that are spearheading PFI and have been seized upon as giving the best indication as to the potential uses and success of PFI.

Transport

Transport infrastructure offers the largest single immediate areas of opportunity for the PFI. Of the projects allowed through in 1995, about 80 per cent were connected with transport. The largest, at £2.7 billion, was the Channel Tunnel Rail Link, followed by the West Coast Main Line modernisation, at £800 million, and the Northern Line modernisation, at £400 million.

The Financial Secretary to the Treasury, Michael Jack MP, recently announced that further projects have been agreed — including the £120 million Docklands Light Railway extension.[12]

The Prison Service

At the end of 1995, negotiations were completed for two PFI prisons at Bridgend and Fazakerley. For the first time, private sector consortia had taken on full responsibility for the design, building, and the running of prisons. The consortia will provide custodial services during the next 25 Years. The Prison Service will retain responsibility for sending prisoners there, and for disciplinary matters. But the consortia will be responsible for other matters that were once entirely the province of the Prison Service education, industrial work, and other aspects of detention and rehabilitation.

Further PFI prison projects are under discussion, which include Lowdham Grange and Killmarnoch.

The National Health Service

Private capital has been sought in the NHS since the internal market reforms of the early 1990s. Under today's PFI approach, a consortium — of John Laing Construction, the General Healthcare Group, and BZW — has been awarded the contract to build a £170 million hospital in Norwich.[13] At the beginning of 1996, 45 smaller PFI projects had been approved by the NHS Executive, with a capital value of more than £160 million.

By the end of 1997, projects worth about £1 billion will have been presented for assessment and approval.[14]

How many of these potential projects will actually get built will depend very much on getting the whole policy approach right. Contractors complain that, far from Alastair Ross Goobeys aim of spreading the lessons of success, each NHS Trust seems to be doing its own procurement, pushing for contract clauses that have proved unworkable elsewhere. Meanwhile the local health authorities and the NHS Executive all get involved in decision–making, leading to contradictions, confusion and delays.

How PFI is supposed to achieve its aims

The overall objective of PFI is to deliver public sector projects more efficiently and effectively through the use of private sector expertise and finance. The primary means of achieving this is through the transfer of risk. It would in fact be better to talk of risk allocation' rather than 'risk transfer' as the latter suggests that commercial risk can simply be moved — e*n masse* — from the public sector to the private sector. Indeed, in the early stages of PFI many public sector clients tried to transfer as much risk as possible to the private sector, giving little thought to what risks could be controlled or could be commercially viable for the private sector.

The transfer of risk is central to PFI because its development was in part an appreciation that the Ryrie rules had the unintended effect of disqualifying a great many private finance schemes on the grounds that the public sector could always borrow more cheaply to finance capital projects. The public sector can do so because the banks know that if a project fails then the debt will be paid by millions of current and future taxpayers; in the private sector the bank may not get repaid, so it charges a higher premium.

However, PFI acknowledges that this simplistic view, overlooks the fact that private capital tends to be managed more effectively than public capital. Since the return on investment is determined by the difference between cost of provision and price of service, and since price will often be fixed by law or negotiated with a single customer, the private sector contractor has a strong financial incentive, not shared by its public sector counterpart, to minimise costs through better management.

The private sector, with its inherent value–for–money commercial culture and free of political interference, can therefore manage projects to work more cost–effectively. Another advantage is that it manages a project in its totality rather than in the piecemeal and short–term way that tends to happen in public procurement. As Securicor, the operator of the PFI prison in Bridgend, puts it

> "As the operator, we were also the consortium leader and this enabled us to create a synergy between design, construction and operation. This relationship is key if PFI projects are to be successful. *It enables the introduction of innovative, more efficient systems which lead to considerable savings in overall costs against traditional methods.* More importantly, it engenders the commitment of the operator to successful service delivery. This is achieved because for the first time in this field, management and staff will in effect actually own the prison for the duration of the contract and we *can thus be held truly accountable for our actions."*[15]

In government–led projects, by contrast, project and financial responsibility is typically very diffuse, so that public projects will typically be subject to frequent delays and changes as consultants and other interested parties (architects, professional associations, trades unions) participate in the process with no financial incentive to ensure that the project is completed on time and within budget.

This difference in culture, method, and purpose is the main reason why the Fazakerley and Bridgend prisons will cost the government about 25 per cent less during their concession periods than going ahead with two purely public sector prisons (according to an estimate by Derek Lewis, former Director General of the Prison Service).[16]

Many critics have observed that the private sector, typically, has to pay a higher rate of interest for the money it borrows than does the government, since the government is regarded as sufficiently large and powerful to make the risk of its defaulting on a loan minuscule. However, the higher costs of private sector capital are offset by the private sector's ability to manage that capital more efficiently, thus enabling PFI projects to be built and run more efficiently than if they would be using conventional procurement methods.

The question of risk

One of the main points of contention about PFI — and indeed the argument goes right back to the early days of private finance under the Ryrie rules — is the question of risk.

Because the government can borrow more cheaply, officials have always regarded private finance as an unjustifiably expensive option, unless the private sector is providing something that is worth the extra. Having overlooked the private sector's superior management of capital as such a valuable benefit, this left them thinking that all the private sector could offer to balance the extra cost was its willingness to take on some of the risk. If there was no risk in the project, then private finance would be just a more expensive sort of public borrowing, and unacceptable; if the contractors bore the risk, then private finance might just be worth paying for.

This view, founded in an oversight though it may be, is still the source of much argument and irritation in private finance projects today. So anxious have officials been to pass risk over to the private sector when private finance is involved that many PFI projects ask the contractor to take on levels of risk so high that they either cannot be accepted, or can be accepted only at a charge so high that the potential gains from the project being better managed because it is in the private sector are entirely negated.

Before pursuing this point it is essential to understand this concept of risk and its role in PFI projects.

Broadly speaking, the risk involved in private finance projects concerns the fact that the contractor will be financially worse off if the project is not delivered and managed in such a way that it meets the terms of the contract, or if the revenue stream (from the client or the customers) is not sufficient to cover the contractor's costs.

There is thus an incentive for the contractor to control the costs and revenue stream. This is not always possible to achieve, but the incentive to do so and the benefits from doing so give private finance projects a certain drive, entrepreneurship and innovation that keeps the whole process tightly managed and makes it better value for money.

There are many different types of risk and the Treasury has identified seven broad categories of risk to consider in most PFI projects:[17]

1. Design and construction risk

The risk involved concerns failure *to* meet the specified requirement, cost and timetable. An example of this was when Andersen Consulting had to pay the government £12m directly in compensation on over–running on the delivery of the National Insurance Recording System.[18]

2. Demand (or volume/usage) risk

This risk relates to the demand for services, i.e. the ability of the contractor to raise sufficient revenue through charges and user fees, etc. This has been a matter of considerable contention (discussed later) as some contracts initially aimed to transfer demand risks to the private sector even though the management of that risk would have been outside the contractors' hands (such as the number of prisoners in a prison at any one time). This is arguably the most important element of risk transfer to the private sector.

3. Residual value risk

This concerns the value of an asset at the end of a contract, which may or may not be fully realisable. This gives the contractor an incentive to keep the assets in good order throughout the period of the contract. An example of this is the contract for the supply of new rolling stock for the Northern Line; the contract is for *20* years yet the trains have a potential life of *36* years. The contractor therefore has an incentive to maintain the trains well so that he is in a good position to get the contract extended.

4. Technology/obsolescence risk

This is the risk that the asset (such as an IT system) will cease to be the technically best way of delivering the service during the lifetime of the contract, and therefore will require the contractor to pay to update the system sufficiently.

5. Regulation and similar risks including those relating to taxation and planning permission

This relates to the risk that the law or regulations may be changed in such a way as to affect the project.

6. Project financing risk

The government considers this to be a risk that should be managed by the contractors and their financiers, concerning as it does their ability to assemble and deliver an economically viable finance package.

Risk lies at the heart of PFI and unless its role is understood and acted upon appropriately by both public and private sectors then PFI projects will not be viable. The City solicitors Wilde Sapte, in their *Guide to the Private Finance Initiative*, make this point forcefully:

> "The way these risks [demand risk and the risk of unforeseen damage] are dealt with will largely govern the security of the income stream generated in favour of the private sector entity. This is particularly the case with demand risk which in most cases will govern the level of project income and profitability.
>
> Without a sufficient and secure income a project will not be capable of being financed. The existence of factors which may de–stabilise the income stream from a PFI project are therefore issues of significant concern to the private sector since they, go to the very heart of the viability of the project. If the uncontrolled risk elements are significant in a PFI transaction they will, at best, result in higher financing costs to take account of the greater risk premium and, at worst, will make the project unworkable."

Yet despite such warnings, not enough thought has been given to whether the private sector can reasonably take on certain risks, or can do so at rates that are not so large as to negate the gains from elsewhere.

The premiums which contractors and their financiers charge for high risks can make the difference between a PFI project being viable or not. In too many cases already, the risk originally being proposed to be transferred from the public to the private sector would have made the projects in question unviable, as was the case with the original prison contracts.

No risk can be transferred to the private sector that is entirely outside its control. This is particularly important in projects where the demand for the facility (e.g. a prison) depends on public policy alone. In a prison building contract, occupancy levels must be the risk of the public sector client and not of the private builder or operator, since there can be no private sector control or stimulation of the 'demand' for prison cells. That is a matter for the Home Office and the courts — not to mention the individual offenders.

For this reason, the first drafts of the Fazakerley and Bridgend concessions were rejected, because they proposed to transfer such uncontrollable risk to the private builder and operator. Thus one tender was framed originally, on the basis of payment per prisoner night. Through negotiation it was revised to payment on the basis of "per available cell per night" and agreed as such.

The government has often emphasised that risk should be allocated according to whom is best able to manage it, and current guidelines from the PFI Executive and the Treasury make this specific. It still remains the case that too often, contractors are simply assumed to be willing to accept levels of risk that have not even been assessed or quantified — a source of delay, irritation and cost all round as such risks are costed out and tenders renegotiated.

There are some hopeful signs that the lessons are now being learnt and that a more pragmatic approach is being encouraged for the future. Yet many officials still seem blissfully unaware of the risks, arid the costs, which they unwittingly load onto PFI contracts.

Over–prescriptive contracts are a prime example. A tender document which states precisely how a certain project is to be built and operated leaves the contractor no scope to manage costs and revenues. If the specifications extend deeply into areas which have a large bearing on costs (such as personnel numbers, grades, hours, pay, conditions, rostas, holidays, trade union representation, pensions...) or demand, then the contractor loses the ability to manage its own risks.

As we have seen, one of the reasons why the private sector is typically more effective and efficient in managing large projects because it brings a total, co–ordinated approach to the task in hand. Unfortunately, such a total approach is not possible when so many risk factors are beyond its control or are extremely difficult to manage, and the matter of over–specificity of PFI contracts remains a considerable source of annoyance and an obstacle to innovation and progress in private finance projects.

Has PFI delayed capital spending?

The government's views on the role and status of PFI in relation to public expenditure and government capital spending in general have changed considerably. In January 1995, the House of Commons Treasury Select Committee noted a lack of clarity about the purpose of the PFI. Originally its role was, according to Norman Lamont MP when he was Chancellor of the Exchequer, only to *supplement* public capital spending; but the current Chancellor, Kenneth Clarke MP, has announced that it would *replace* public capital spending.[19]

While it may be an admirable goal in principle for PFI to replace rather than supplement existing capital projects, the net result has been delays on public capital projects which would have otherwise been perfectly routine procurement projects. This is because they have to go through the more complex process of specifying and tendering PIT projects, which have taken a good deal longer. Contractors have complained about the gap which this delay caused in their work schedules, with disastrous effects on cash flow. Instead of boosting the private sector, the move to PFI caused it considerable financial problems.

Indeed, the criticism that PFI has delayed badly needed public sector capital projects has been made very widely. PFI has not made up for the shortfall in conventional government capital spending. The government's Budget plans show expenditure under PFI running at £2.8 billion in 1998/99, from nothing in 1992/93. However, this does not adequately compensate for the fall in non–PFI capital spending, from £21.7 billion to £19.2 billion (which includes National Lottery spending). That is a drop in real terms of 12.5% in the total value of publicly secured capital spending over this period.

On the bright side, however, PFI contracts are getting quicker to agree as both sides learn what is and is not possible and which sources of delay can he eliminated. The Panel says that the average time to procure a new prison, for example, is now down to nine months.

At the same time, officials are coming to understand that it is a serious mistake to impose the complexities of PFI on projects for which PFI may be inappropriate. The guiding principle now is to test only those projects where there is a reasonable chance of a PFI solution being acceptable, and that the level of testing should be varied according to the size of the project so that small projects are not smothered with undue costs.

Contractors are perhaps waiting to see whether this new guidance from the top actually changes how procurement projects are run at the bottom. Given the non–commercial culture of public officials, in some cases they may not even recognize these sources of cost and delay, never mind be able to measure and reduce them. Unless public sector clients get better advice from outside, inappropriate and over–costly testing is likely to continue.

Is PFI a form of disguised borrowing?

Some people argue that PFI has turned out to be merely a way of concealing public borrowing by putting it off–budget. Though it does not appear on the PSBR and public expenditure figures, the argument runs, it should still be considered as public spending because the investment decision is not one made freely in the private sector. So while it would appear to reduce the size and scope of the state, it does in fact do nothing to change the fact that it is ultimately within the state sector.

The *Economist* magazine has been one of the leading critics along these lines, condemning the PFI as a 'scam' on the taxpayer:

> "A government wants to please voters with a new road or hospital, but its budget is already used up. So it persuades a private firm to stump up the money. Ostensibly, the private partner takes on some of the risk, but in practice it is likely that the government will ensure, one way or another, that the project succeeds. This has at least two consequences. The first is that this private finance is really public borrowing by another name; so this creative accounting (what beancounters call off–balance–sheet financing') obscures the true state of the government's finances. Secondly, it increases the price that the government pays for its capital. Because of its low default risk, the British Government can borrow more cheaply than can any private investor."[20]

Phillip Stephens of the *Financial Times* echoes this sentiment:

> "The reality is that no–one, least of all the Treasury, has any idea whether the PFI will ultimately provide a good deal. The scheme has been designed by politicians in search of a free lunch. To that end, the likely cost has been deliberately obscured. But the bills will only begin to roll in five, ten or fifteen years hence.... As now constituted the PFI is a blank cheque for a Labour government, a cheque signed in advance by the Conservatives."[21]

Yet the *Economist's* concept of the Public Sector Borrowing Requirement (PSBR) is flawed. Including a variety of other projects in with the FSBR distorts the public finances as all expenditure is regarded as equal in principle, whether it is an investment that will be recouped eventually or a set of transfer expenditures (such as social security) that will reap no return. Clearly we should he looking at the wider situation, mindful of these differences, instead of trying to lump different things into the same measure.

The *Economist's* second charge is plainly wrong. While it is true that the government can usually borrow more cheaply than the private sector, this cost should be more than offset by better capital management and better project design that makes the new facilities cheaper to run over the years to come. Indeed, under Treasury rules, PFI projects must offer better value for money than viable alternative procurement routes in order to be approved at all. Though Phillip Stephens is correct in saying that the bills for PFI may roll in over the next 10–15 years, the bills will be smaller than they would have been for an equivalent set of conventionally procured projects.

3. Assessing the Initiative

There are several different ways in which one can assess the progress of PFI to date. One way is to measure the number of schemes approved; another is to look at the number of projects under consideration; and another is to examine the level of interest shown by private sector contractors and financiers.

By this last criterion, there is good reason to be optimistic. According to the London *Financial News,* "at least 50 of the biggest financial institutions have either set up Greenfield PFI departments or have developed them out of existing project finance".[22]

That may indicate the degree of interest in PFI, but it tells us nothing about the record of implementation — the key criterion for those contractors that have been investing significantly in the hope of winning PFI business. And although there are many PFI projects under consideration — a point made over and over again by ministers — there have been very few successful PFI projects to date, with (as we have seen) only 100 out of the 1400 potential projects yet agreed.

By this criterion, according to Roland Wales, Director of the Policy Research Group:

> "The PFI has been a spectacular flop. Since it was announced, less than £500 million has been found to augment public–sector investment, with a further £500 million expected by the end of this financial year."[23]

To defend themselves against this criticism, departments have blamed the steepness of the learning curve that is faced by everyone involved in PFI work. However, PFI has been running for four years and still the majority of people who are crucial to its success think that rather little has yet been learnt. Contractors say that Whitehall still has not come to grips with risk management or appreciated the enormous costs and delays resulting from their vague, indecisive, and unbusinesslike approach. Meanwhile, the new head of the NHS Private Finance Unit, Andrew Neil, complained that he spent his first seven weeks speaking extensively to banks and financiers because "it had become clear that some of them had not yet done sufficient work to understand what we are asking the consortia to provide".[24]

According to a recent Gallup survey carried out for Richard Ellis, the leading property company, the "overwhelming majority of international investors" are not convinced that the PFI can be made to work. A recent Department of the Environment survey showed that 84 per cent of private firms that are actively trying to get involved in the PFI have experienced difficulties; and three–quarters of these have been unable to solve those difficulties.

It is not surprising, then, that contractors have become very much more careful in selecting the opportunities they will go for in PFI and the others that they will leave aside. Even if all of the 1400 potential projects now identified get past the feasibility stage, many of them will still prove to be unattractive to the private sector on which the Initiative depends.

Problems to be addressed

A large number of other specific criticisms have been thrown against the PFI, and it is worth considering a few of these in turn.

In some cases there is hope that the lessons of past mistakes have been learnt, though it remains to be seen whether the new directives from the centre will actually have much of an effect at the interface of customer and client. In other cases, it is clear that only a new sense of drive and direction from the policymakers will ever be able to capture the full gains that PFI should make possible.

Fragmented structure

While it is encouraging to see PFI being considered in more and more areas of public service provision, this does mean that very large numbers of people across government are now becoming involved in PFI projects, and that many of those will unfortunately have very little experience of this kind of work. Furthermore, different departments, agencies and units may all be involved in any single project. The result of both these factors is that decision–making is often slow and ill–informed or politically rather than commercially driven.

There is no single body with the authority to keep PFI projects on track. There is the Private Finance Panel, but this has no powers to intervene in individual contract negotiations, and is mostly confined to making recommendations and setting guidelines. The Executive in the Treasury is arguably too small to manage the large number of projects that are being considered. Some argue that its performance has not been as good as that of the same departments privatization team, which quickly established a good reputation in its role of accumulating and disseminating knowledge and best practice information about privatization.

The fragmentation of responsibility across government departments can be very serious for everyone involved in PFI contract negotiations. For example, road projects can involve the Department of Transport, the Department of the Environment, the Treasury and the Ministry of Agriculture, not to mention the Department of National Heritage or the Office of Public Service and Science, if heritage or scientific interest sites are involved. Decisions are slow and take armies of lawyers to advise, check, and interpret.

These problems are multiplied beyond the departments themselves. In health, for example, PFI projects involve not only the Trust in question and each Trust seems to have its own way of doing things and there is little learning by any one from experience of others — but also its health authority (which typically purchases most of the Trust's services), the National Health Service Executive and the community health councils. In addition, a host of professional bodies are involved, many of whom are wary and cautious of PFI, and who have no incentive to ensure that PFI projects are not delayed.

Michael Jack MP promised that individual ministers would be responsible for pushing through individual projects and overcoming these sorts of bottlenecks; but ministers are busy and it is clear that the bottlenecks are still there. Clearly there is a need for a new policy which will cut through the red tape and produce fast arid rational decision–making.

Cultural differences between public and private sectors

Public and private co–operation in the past has, with the exception of some infrastructure and defence projects, traditionally been at arms length, with the private sector acting solely as a provider and not a financier. PFI does, however, require a much closer working relationship between public and private sectors and its success demands that both sectors understand each other well and progress projects in ways that meet the requirements of both.

Unfortunately, there have been many cases where the private sector has found that the public sector client has little understanding or sympathy for the commercial pressures they are under and what makes a PFI project viable for them. Equally, in the early days of PFI it seemed that the contractors did not really understand what the government wanted to achieve — although this might have stemmed from the vagueness of politicians and officials on that very point.

This cultural divide is not something that can be overcome merely by training courses or official guidance. It is the product of the fundamental difference between working in a commercial environment and not. The financial penalties which eliminate slow decision–management, loose management and procrastination are hard to impose on public servants and public bodies. But perhaps we need to investigate other ways in which to make officials suffer the consequences of poor performance in PFI.

Another strategy might be to transfer more of the project management on the client side to private sector consultants who can be more easily subjected to penalty and given the incentives to ensure that the client role is handled efficiently, effectively and within realistic time limits.

Tender lists are too long

The problem of over–long tender lists is one of the most recurrent criticisms by contractors, primarily because the length of tender lists (five or more is not unusual) is far longer than the norm in their own industries. The custom within the construction industry, for example, is that only three or four companies are invited to tender for design and build contracts. The purpose of this is to minimise the risk of tendering, so that companies do not incur large costs with little prospect of winning the bid.

By contrast, the Home Office recently invited tenders to build two secure training centres. Its tender list for one of these contained eight contractors, and the other contained nine. Several firms refused to tender purely because the tender list was too long.

Depending on the project, if there are eight companies on a tender list, it means that perhaps as much as £4 million has to be spent on bidding alone. There being only one winner in any bidding process, seven–eighths of that will have been spent to no productive use.

There is a limit to how far contractors are willing to bear such costs in the hope of recouping them on another occasion. The resources they waste could have been used to better effect elsewhere, at home or in overseas markets. Company managers responsible for developing PFI business have to justify the large amounts of time and money spent on winning tenders; but many of them have little to show for four years' work and their boards are deciding to rein in that expenditure.

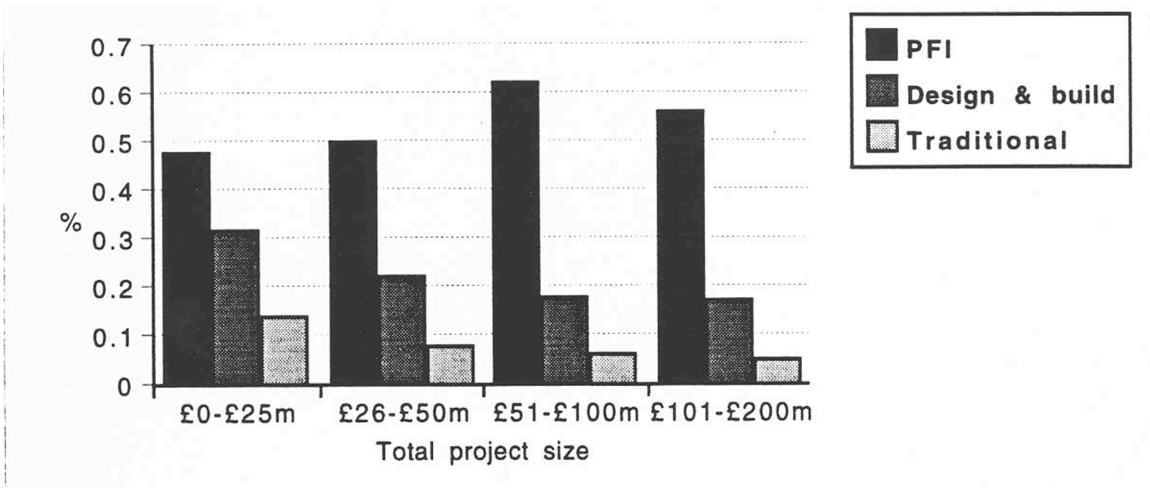
Again, there are signs that this problem is now understood, at the top at least. Published advice from the Treasury arid the Private Finance Panel states that tender lists should be limited to three or four companies. It will take time to see how far this advice is affecting practice on the ground.

The cost of tendering is too high

Another complaint is the costs of tendering for PFI projects, which are often far higher than in traditional tendering for local or central government work. Of course, this is in part due to the fact that it is not just a capital project that is being bid for, but the whole business of building, maintaining, and operating the asset over perhaps twenty or thirty years. This makes the whole process much more complex and so it is to be expected that bidding costs will be somewhat higher.

The contractors, however, argue that even with this in mind, the costs of tendering for PFI work are discouragingly high and need urgent attention.
There are substantial costs in putting a consortium together in the first place, before a bid is put together. Assembling a consortium of builders, civil engineers, designers and financiers can itself cost millions. The costs of actually preparing a bid and going through the tendering process are also much larger than in traditional procurement, and are a big disincentive for firms thinking of entering a new and largely unknown market.

There is little hard evidence of what companies' tendering costs actually are, since they are usually confidential, though some evidence does exist. This can be seen in Figure 1, below, where average tender costs — expressed as a percentage of the expected total costs of the project — are compared across different project sizes and four procurement routes. The PFI figures were obtained from a confidential survey of major contractors' tender costs for a number of major transport, health and prison projects.



Source: BEC, and Sir Michael Latham, *Constructing the Team*

Three main points emerge from these figures:

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

These points emerge still more clearly from looking at the unweighted average tender costs, across all project sizes, as in Figure 2 below. When multiplied by the rough average number of bidders that can be expected to compete for comparable projects, the total cost to potential contractors of preparing and entering their bid becomes clearly very much larger with PFI projects than it does on conventional procurements.

Too many unsuitable projects

Speaking in November 1994, Mr Clarke announced that, henceforth, the Treasury "[would] not approve any capital projects unless private finance options [had] been explored".[25]

While this makes sense as a method of expanding the scope of the PFI — and was welcomed as such — it does lead to unnecessary costs for the private sector.

Figure 2: Average tender costs as % of total costs all project sizes

Project type	Average tender cost	Average number of bidders	Total tender costs
PFI	0.54%	5	2.7%
D&B	0.22%	3	0.66%
Traditional	0.09%	7	0.63%

Source: *ibid*.

All the time, private firms are being invited to tender for projects which are not suited to PFI. In many cases tenders have been invited with little thought to the extremely high cost implications for the private sector.

Excessive testing is particularly unnecessary as most projects now being considered for PFI have already been market tested under the government's *Competing for Quality* programme. Often it is difficult then to see where or how the private sector could be involved, or why they would be interested.

The private sector may see an opportunity if it could manage the risk effectively and profitably. But this can be achieved only if it is given a reasonable level of control over service provision itself, rather than merely the supply of the assets from which services are provided. This is particularly true of projects such as hospital facilities, where great gains in efficiency and effectiveness could be made if the private sector could manage all the elements in the project (including the management of clinical services) which are seen as "politically impossible" today because of the large vested interests involved.

Too many projects under consideration

The fact that so many projects are under consideration may be a reason to be optimistic about the future of PFI. But quite apart from the unsuitability of many of these projects for PFI, the mere fact that so many are under consideration should and does give cause for concern.

There are several reasons why. The first is that, although PFI is four years old, there are not enough public officials with sufficient experience and understanding to ensure that all PFI projects are handled effectively. The consequence is that the public sector, particularly the NHS, is groaning under the weight of PFI and is having to spread its time and expertise too thinly across many projects. So it is unlikely that many projects, even the most suitable ones, will progress very quickly.

The stretching of resources on the public sector side is mirrored in the private sector. This is particularly true with regard to the larger infrastructure construction projects as there are only a few companies that are capable of handling projects of such scale. At the moment too many large projects are being funnelled through too few large contractors.

The sheer number of projects has led to bottlenecks on both the public and private sector sides. Many PFI projects require specialist expertise, even before they are awarded (in undertaking feasibility studies, drawing up tender documents, and making bids, etc.). There are a limited number of people who can do this work and it is inevitable that in a system where resources are already stretched, bottlenecks will arise as projects go through their many different stages. One contractor has been quoted as saying that "Companies are simply running out of people who can put together these sorts of projects, which are all different and need different risk evaluations".[26]

An additional factor which needs to be taken into account is that many firms, even the large construction companies, cannot afford to win too many projects as it is not viable for them to have too much exposure on their balance sheets. This means that firms have to be very selective in which projects they bid for and take on once they get preferred bidder status. If the only projects being put to tender were those that had been carefully sifted to ensure their commercial viability, the private sector would have more confidence in PFI. At the moment many contractors are justifiably sceptical that many of the projects they have been invited to bid for would meet this condition.

The Panel, for its part, argue that a more realistic approach is now being taken to risk. PFI specialist funds are beginning to emerge, so that the need for construction companies to carry large PFI projects on their balance sheets is likely to be reduced as time goes on. There may even develop a market in which companies can sell their equity after the end of the construction phase, thereby taking it off their balance sheets. Once again, however, it has to be said that the specialist funds are still small in relation to the number of projects and volume of PFI business that is being mooted by the Chancellor and his colleagues; while the emergence of resale markets remains an uncertainty which contractors cannot rely on when they are considering PFI opportunities right now.

Lack of sufficient information

Companies involved in PFI work say they are rarely provided with all the information that should reasonably have been made available.

For example, a central government department will often test a PFI option against a public finance option, to *see if* it represents value for money. The results of this test are seldom revealed. Nor, where a real tender is involved, will it be revealed what weightings will be attached to matters such as price, service quality, staff qualifications, labour relations record, and so forth. In the absence of such information, a private firm will unwittingly continue with a proposal that has no hope of success — imposing significant costs that will deter it from entering the process again.

Firms experience of pursuing such projects is a significant deterrent to them participating in other PFI projects.

Lack of clarity in public requirements

Even where projects may be suitable, firms have often been called in too early; often, a public sector body has not by then even defined what service it requires. The result is costs and delay on both sides as decisions are made, and changed, as the process goes along.

This complaint has already been acknowledged by the Treasury, and new guidelines have been issued to those departments and other bodies that are interested in the PFI. It has also been acknowledged by the NHS Executive. However, this guidance is often ignored at ground level. Perhaps some officials simply do not realise that their requirements capture is poor and their plans are inadequate or vague. So contractors and consultants are having to spend very large amounts of time and money on discussions in which they do not really need to be involved.

There is a buoyant market in professional advice, from lawyers and management consultants, to private sector clients as to how they should frame their bids. (Indeed, it is arguably rather too buoyant as a result of the unnecessary complexity and bureaucracy in PFI work!). Public sector clients use advisers too, but perhaps this use can be made more general, more systematic and more focused.

Perhaps we should require public sector bodies to take professional private sector advice at the very earliest stage, when they are thinking about what services they require and how they are going to ask for them. A more businesslike approach to requirements capture and tender specification would give many PFI projects (and traditional procurement routes too) a greater prospect of commercial success.
This external professional expertise can be extended more deeply, into the evaluation of bids, so that commercial considerations can be represented alongside the political and organisational ones with which public officials will be more familiar. This deeper professional guidance is likely to make the evaluation and negotiation stages run more quickly and smoothly, encouraging contracts back into competition for future PFI projects.

Contracts are too short for commercial viability

In order for finance to be worth raising to build and operate projects, concession contracts need to be long enough to achieve a reasonable return on capital. This is true not merely for large projects, like prisons and roads, but also for much smaller projects, like car parks and hospital facilities.

While the need for longer concessions appear to have been recognised in large projects, the problem still exists with regard to smaller ones. This is particularly important in the NHS where there are hundreds of relatively small–scale projects (say, under £6m) which are unlikely to appeal to the private sector unless the contract lengths are adequate.

One medium–sized contractor with extensive experience in hospital construction considered taking on several PFI contracts in the health sector, each with a value of up to £6 million. He rejected these, because the concession contracts offered were typically less than eight years. For them to be worth taking on, he estimated that he needed concessions nearer to 20–25 years.

There is no reason to suppose that this experience is unusual, at least in the NHS sector. In education, many small projects are being given contract lengths of 20 years or more, since the revenue is small in relation to the size of the capital asset. But in health, despite all the promises made of it, there has been little clear progress beyond the Norfolk and Norwich Hospital.

The Financial Secretary's nationwide tour to promote PFI to local businesses[27] is unlikely to bear many fruits unless they can be convinced that it is worthwhile for them to get involved.

Poor credit status

The credit status of many public bodies is poor. This is particularly the case with the NHS trusts, some of which are technically insolvent. Banks are naturally wary of dealing with them, so the cost of credit is higher (by perhaps one percentage point) than for dealing with other public sector bodies. The internal market, which has exposed the financial weaknesses of many trusts, could ironically be a force for limiting the penetration of PFI.

Where assets like student accommodation are concerned, the asset itself can serve as security, because it can be used for other purposes. The banks therefore do not need to build in such a high premium for the risk. But few clinical facilities can be converted to other uses, and the NHS is the only realistic tenant or customer for them. As a result, some health PFI proposals are unable to satisfy the value for money test; with the result that the whole PFI is being biased away from areas where private funding is often most seriously and urgently needed.

Unacceptable contractual terms

Disagreements over contract terms have been a significant obstacle to progress in many projects. Sometimes this is the result of including clauses which are perfectly routine in traditional procurement contracts but which are disastrously wrong in the PFI context.

For example, traditional procurement contracts include a standard clause allowing the government to terminate a contract without compensation if officials receive payment or gifts in connection with the contract. And indeed, severe penalties against fraud and corruption are perfectly proper. In the PFI context, however, the punishment would seriously outweigh the crime if even an unintentional breach by an employee or sub–contractor could lead to the termination of the contract and the confiscation of the whole PFI asset.

It is on such technical hiccups that PFI contracts often come to grief. Where risk is difficult to manage, and the potential losses are large, any private sector contractor will charge a premium that may be large enough to make the project untenable. But if the exposure is so high and the risk impossible to control, then there will be no investors at all.

4. Proposals for reform

There are many changes that could be made to improve the working of PFI within the current framework, but these will have little impact unless policymakers inject a sense of drive, direction, and commercial realism into the very body of the policy.

Priorities and project minders

In the immediate term, however, the key to restoring confidence in PFI over the next twelve months is to ensure that a handful of pathfinder projects in each department — probably no more than four in each — are prioritised and given a deadline of, say, the beginning of the next financial year to be signed off.

This requires that projects be driven forward and that avoidable delays, bureaucracy, indecision and confusion are tackled swiftly and early on by dedicated “minders” who can pilot through each project.

To make sure that every project starts with clear vision from a basis of commercial commonsense, one such “minder” should be attached to each project as soon as it is identified as a potential PFI project.

From inception, through feasibility analysis and project design, to bidder selection, tendering, and up to the award of the contract and beyond the “minder” should have the power and responsibility to guide each project quickly and efficiently through the departments and agencies involved, to set timetables, to demand firm decisions, to resolve disputes between public bodies or between public bodies and contractors, and to ensure that the process stays commercially sound and free from unnecessary cost and political interference.

Ministers are unlikely to make good minders. The task requires someone from the private sector, perhaps an individual member of the Private Finance Panel or — if it were thought improper for Panel members to get involved in individual contracts — an appointee chosen for the purpose.

The minder system would introduce much–needed consistency and a level of advocacy for the project that is sorely missing from the process at the moment. Most importantly, it would ensure that one person would be able to supervise the process as a whole and ensure that projects are not compromised through unnecessary delays and expensive and constricting over–specification

Client advisers

As already suggested, there may be a need for better private sector advice on the client side. This policy needs to be pursued with clarity and care, because the point is not to bring in yet more advisers who will complicate and slow down the process even further. The point is to add clarity to what the public sector client wants to achieve, and to simplify and improve the process of specification, tendering, negotiation and bid evaluation.

There is clearly much mote that can be done in terms of requirements capture and packaging PFI deals. Often the package of service functions that one particular department has in mind and has always run simply does not make sense as a commercial proposition; but when some functions are transferred elsewhere, or parallel functions from other departments are included in the package, a much more viable scheme can be built.

Better advice can also help in terms of assessing non–compliant bids — where contractors themselves have identified better ways of providing the desired service that are not in line with the public sector clients preconceptions about how they should be achieved.

Other policy options

The options outlined above — **prioritising a very small number of projects**, appointing **project "minders"** and getting better **outside advice on project design and evaluation** — could greatly assist in progressing PFI within the current framework, but there are other ways in which the basic framework and procedures could be improved.

Policy and organization

- The government should make a **clear policy statement** about the exact role, aims and expectations of PFI. This will reduce uncertainty and introduce greater clarity of purpose among public sector clients and private sector providers.

- The policy re–statement should **make it clear that the PFI is not just about financing, but is about new and better public service provision**. This will help concentrate minds on the intended outputs, rather than on financial intricacies; and it may help to show NHS providers and local authorities that the Initiative is about public service development, and is not just 'backdoor privatisation'.

- **The Private Finance Executive should be transferred out of the Treasury** and into the Office of Public Service or the Deputy Prime Minister's office. This allows an impartial senior minister to take direct control over a policy which straddles departments, and which is properly about public service rather than mere finance. It raises the status of the initiative and defuses any friction between the Treasury and other departments, particularly at the time of the annual expenditure round.

- **The Executive should be strengthened** so that it has sufficient resources to oversee the progress of the prioritised projects and ensure that the best practice is widely communicated.

Project suitability

- **Each PFI project should have a clear timetable** which should be made public at the earliest possible stage. This warns civil servants and consultants to take care before doing anything that might introduce delays into projects that could not be justified to the Private Finance Panel, to Parliament and the responsible ministers.

- To avoid contractors' time and money being wasted on departmental fishing trips — as they have often been in the *Competing for Quality* process of market testing civil–service functions — **potential bidders should be invited to tender only when there is a clear intention to award a PFI contract**. This may require more than mere guidance from the Executive: it may require penalties on departments and agencies which do not comply.

- The rule whereby all projects are tested against a PFI option, **the blanket testing requirement, should be abolished**. Projects should be tested only where experience suggests the exercise will be productive; the degree and complexity of the testing should be related to the size and nature of the project, or there should be a size threshold below which no testing is required.

- **A database of projects** which have been deemed unsuitable for PFI should be created in all departments so that similarly unsuitable projects are not advanced, but are procured in traditional ways.

Contract specification

- The government must insist that **public bodies should clarify their needs before approaching prospective PFI bidders**. Potential contractors should not be called in without there first being a good reason for doing so.

- The specification of PFI projects should **concentrate on general outputs rather than detailed specification of inputs**. Contracts should be written in terms of the service objectives to be achieved (such as providing a selected range of health services for a local population) rather than in terms of what assets may be thought necessary (e.g. building a new hospital in a specified location).

- **Over–specification must be stopped dead**. The incentives on civil servants are to protect themselves by specifying how any tendered service is to be delivered in the most minute detail. These incentives must be reversed, which requires policy changes from the top.

- **Contractors with preferred bidder status should be able to appeal against overspecification**. Both sides should know that the contractor can appeal to the project minder if it seems that contracts will be or have been specified to an unreasonable degree, and that the minder will have the power to rule out any such unreasonable burdens.

- **There should be more serious evaluation of non–compliant bids**. Firms with wide experience in running large projects may well have all kinds of fresh ideas about how the desired service could be provided. Again, the present incentive structure does not encourage public sector clients to consider these very seriously, and this must change.

- There should be **a time limit on when new specifications can be added** to the original contract terms. The cost of meeting such changes should be chargeable to the client and not borne by the contractors.

The tendering process

- **Preferred bidder status should be awarded as soon as possible** and the timetable for doing so made known to the public. This reduces the waste of time and money by contractors who in fact will have little prospect of being invited to tender or of entering a successful bid.

- **Tender lists should be restricted to no more than three or four bidders**. Without closing the tendering process to outsiders, care should be taken not to make tender lists longer than is the custom **within the** relevant industry.

- **Bidding costs should be reimbursed in full if a project is pulled**. When a decision is made not to go ahead with a project, but that decision is not connected to the viability of the tenders received, it is unreasonable to leave contractors bearing the cost of all the work they have done in order to mount a bid.

  The Highways Agency already has such a provision and this should be adapted by other agencies and departments. In evidence to the Treasury Committee, the leading engineering consultants, WS Atkins, said:

  > "We believe that the future success of PFI is dependent on the government being prepared to compensate bidders for their costs incurred after appointment as preferred supplier in the event that a decision is taken not to proceed with the Project".[28]

Risk evaluation and transfer

- **Prospective PFI bidders should be invited to tender only once the issues of risk transference have been resolved** to the satisfaction of the project "minder" or the Private Finance Panel. Wrangles about risk transfer, often stemming from cultural differences between public and private sectors, are a serious cause of delay in PFI projects.

- **The risks to be transferred to the private sector should be clearly specified** so that it is easier to evaluate the viability of the projects.

- **Projects in which the risk element is easier to identify, evaluate, and transfer should be given higher priority** than those which may well seem more important but which could get easily bogged down in the complexities of risk evaluation and transfer. This will help to move the most practical PFI projects more quickly to conclusion and so increase the experience from which lessons can be drawn about the handling of more difficult projects.

Conclusion

The principle of PFI should be supported by all political parties because it represents the best hope for generating much–needed funding for substantial new capital projects, particularly in renewing Britain's inadequate transport infrastructure.

It also has the potential to transform the way in which the public sector achieves its goals. PFI should be taken as an opportunity to introduce private sector innovation and management techniques into the heart of government, thereby spreading best practice into non–PFI areas. It would be unfortunate then if problems on the public sector side, which could be overcome relatively easily by clearer direction and by policy changes from the top, were to undermine the principle of PFI and thus discourage public and private sector participants from realising its full potential.

It is essential to get PFI off the ground and renew confidence in and commitment to it by all interested parties. In the longer term Whitehall needs to understand that the key to realising the full potential of PFI is to allow the private sector to be as innovative as possible in suggesting innovative private sector solutions to public sector challenges.

Notes

[1] FSBR, 1996–7, Fare 6.22. Quoted in Sixth Report: *The Private Finance Initiative*, Treasury Committee, April 1996, p.lx
[2] Kenneth Clarke MP, Chancellor of the Exchequer, quoted in "Clarke defends private initiative", *Daily Telegraph*, 17 July 1996, p.24
[3] 'A bridge between public and private' *The London Financial News*, 10–16 June 1996
[4] Kenneth Clarke MP, Chancellor of the Exchequer, quoted in "Clarke defends private initiative", *Daily Telegraph*, 17 July 1996, p.24
[5] Quoted in Andrew Adonis: "Seeking capital other initiatives do not reach", *The Financial Times* London, 5th June 1995
[6] "Private finance 'falls short'", *Daily Telegraph*, 27 June 1995
[7] p.vii Sixth Report — *the Private Finance Initiative*, The Treasury Committee, April 1996
[8] *See Private Opportunity, Public Benefit*, Private Finance Panel Executive, November 1995, pp. 19–20
[9] Alastair Ross Goobey, "Climbing the investment learning curve", in *Parliamentary Review*, July 1996.
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[13] Andrew Cave, "Boost for private finance scheme", *The Daily Telegraph*, London, 4th April 1996
[14] Andrew Neill, "Applying PFI to the Health Service", *Parliamentary Review*, London, February 1996
[15] Securicor Custodial Services, *Breaking New Ground with Government*, 1996 (emphasis in the original)
[16] Source: Andrew Adonis, "Seeking capital other initiatives do not reach", *The Financial Times*, London, 5 June 1995
[17] See *Private Opportunity, Public Benefit*, Private Finance Panel Executive, November 1995, pp. 19–20
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[19] Andrew Adonis, "Privatization flagship aims to satisfy critics", *The Financial Times*, London, 23rd January 1995. See also Malcolm Bruce MP, "Letters to the Editor: Doubts about finance initiative", *The Financial Times*, London 19 January 1995
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[25] Speech in Birmingham to the Confederation of British Industry's annual conference, 8th November 1994 — Source; Ross Tieman, "Clarke forces pace on private funding", *The Times*, London, 9th November 1994.
[26] quoted in 'A bridge between public and private' *The London Financial News*, 10–16 June 1996
[27] Reported in 'A bridge between public and private' *The London Financial News*, 10–16 June 1996
[28] *Sixth Report — the Private Finance Initiative*, Treasury Committee, 1996, p.xvii