PFI in the NHS did not deliver value for money under Labour. It is unlikely to do so in the future under the Conservatives.

The use of the private finance initiative (PFI) to fund major capital projects in the NHS has been controversial since its inception in 1992. But the Secretary of State's recent slamming of Labour's PFI legacy, amidst a raft of reports criticising the PFI process, has re-ignited the debate. **Sean Boyle** *finds that PFI policies in the Health Service lie on shaky ground and that both Conservatives and Labour are to blame for borrowing money at unsustainably high rates.*

According to a Daily Telegraph report last month, Secretary of State Andrew Lansley claimed that he was contacted by twenty-two NHS trusts that were struggling to cope financially because of the excessive costs of their PFI contracts. He went on to blame previous Labour governments for this, saying;

> *Over the last year, we've been working to expose the mess Labour left us with, and the truth is that some hospitals have been landed with PFI deals they simply cannot afford. Like the economy, Labour has brought some parts of the NHS to the brink of financial collapse*

Is there any substance in the claim that 22 trusts are in severe financial difficulty due to PFI alone? PFI is only one of many cost pressures that NHS trusts are facing in the current financial climate – with falling real levels of public expenditure on health a key factor. According to the National Audit Office (NAO), the total annual cost to the NHS of PFI hospital projects operational by April 2009 was £890 million. This includes fees associated with paying back the original capital cost of the buildings and fees for facilities management and other ancillary services like catering, and represents a small fraction of the overall costs of these trusts. The Treasury estimates that when all Department of Health PFI projects are taken into account, the annual charge in 2011/12 will amount to over £1.5 billion and will increase over time to as much as £2.5 billion. The NAO found that while the costs of providing facilities management and other services vary between hospitals, differences between PFI and non-PFI hospitals are not statistically significant except in the case of estates maintenance, where average annual costs have tended to be higher in PFI hospitals. Instead, it is the cost of repaying the original investment that has made the most difference.

Some trusts are experiencing PFI costs which are a higher proportion of their total costs than the national average – over 10 per cent in some cases. These trusts may be running into difficulty as a result of their PFI schemes. But as the King's Fund pointed out this is partly due to the NHS payment-by-results system, which funds only the average cost of a particular service (based on the average cost of providing services across all hospital trusts in England) to trusts for the use of capital. Any trust with above average capital costs could be in difficulty unless it is able to offset this additional cost in some way – for example, by delivering services more efficiently. Some of the Lansley trusts may well be in this position but given that the Department of Health has just announced that it is undertaking an independent assessment of PFI schemes, it seems both premature and unhelpful for the Secretary of State to focus on these 22 trusts for what appears to be short-term political gain.

Was PFI really Labour's baby?

Although it is true that PFI was enthusiastically endorsed by successive Labour governments, it was in fact introduced by a Conservative government in 1992. By

May 1997 when Labour came to power, 70 PFI schemes were already in the NHS pipeline.The floodgates would have opened for PFI in the NHS whichever party had won the May 1997 general election.

Credit: Paul McCoubrie (Creative Commons BY ND)

So if Labour cannot be blamed for coming up with the idea of PFI, is Lansley's point that PFI was not implemented as well under Labour as it would have been under a Conservative government? If so, then what is his evidence? Or were there fundamental flaws in the PFI process which would have eventually been revealed whichever party was in power. To examine this we look briefly at why PFI was introduced.

Why PFI?

Most commentators were agreed that the poor state of hospital buildings in 1980s and 1990s indicated a need for substantial capital investment.

Since 1997 all major capital schemes have been required to consider the use of private finance by testing the value for money of a PFI option against the use of public-sector capital. In each case a notional amount was added to the public sector costs to take account of the transfer of risk to the private sector relating to cost and time overruns. The outcomes of such tests now look more and more questionable. The estimation of risk is an inexact science but it seems more than coincidence that the value of the risk transfer from the public sector to private was just enough to tip the balance in favour of PFI in almost every case. And this remained so even when the Treasury discount rate fell from 6 per cent to 3.5 per cent in April 2003**.** Almost all the early PFI projects would have failed the test at the new 3.5 per cent rate – or would they have?

The premise underlying both Conservative and Labour governments' use of PFI was that the private sector would be better able to deliver value for money than traditional procurement using Treasury funds. Recent reports – including the Secretary of State's own remarks– seem now to give the lie to this view. The Public Accounts Committee noted that '*The use of PFI has been based on inadequate comparisons with conventional procurement which have not been sufficiently challenged*'.A report from the Treasury Committee in August 2011 is also damning in its appraisal of PFI over the last 20 years. In particular the Committee states:

> *The price of finance is significantly higher with a PFI. The financial cost of repaying the capital investment of PFI investors is therefore considerably greater than the equivalent repayment of direct government investment. We have not seen evidence to suggest that this inefficient method of financing has been offset by the perceived benefits of PFI from increased risk transfer*

The Committee finds no evidence because there is none. But it is not just benefits from increased risk transfer that have not emerged. If there were going to be real benefits from using PFI then these should have manifested themselves in improved efficiency in the new hospital buildings as well as improvements in quality. But evidence of such improvements is sadly lacking.

Another important reason for going down the PFI route was to allow investment in public sector infrastructure while avoiding an increase in the level of public sector debt. But this was certainly not a good enough reason for taking on a method of financing that was to prove so much more expensive. Again the Treasury Committee report castigated the government for pursuing this option, stating:

> *PFI continues to allow organisations and government the possibility of procuring capital assets without due consideration for their long-terms budgetary obligations*

Would PFI have been done differently under the Conservatives?

It is highly unlikely that it would have been. However, we now have an opportunity to observe Conservative implementation of PFI in practice. To March 2011, another £7 billion of PFI projects (covering all state sectors) have been agreed since the Conservative coalition government came to power in May 2010. In the NHS there are £2.9 billion of PFI projects under construction and another £1.4 billion in preparation or procurement stage. Will these projects suffer from the same shortcomings as their predecessors? The answer is probably yes. In the words of the Treasury Committee,

> *If PFI is the only option for necessary capital expenditure then it will be used even if it is not value for money. A much-needed reappraisal of PFI needs to be accompanied by a similar reassessment of its effects on overall capital spending*

The country needs modern health care facilities. But at a time when we are in the direst of financial straits, it seems strange that the current government is intent on continuing to borrow money at high rates to maintain a level of spending on infrastructure. As the Treasury Committee stated, '*The cost of capital for a typical PFI project is currently over 8 per cent – double the long term government gilt rate of approximately 4 per cent*' Instead the government should follow the Committee's advice and look to buy up the debt and equity of existing PFI projects, thereby achieving a considerable reduction in ongoing annual costs.

Perhaps Lansley, Osborne and Cameron should take their own advice and pay off their credit cards rather than maxing out on them.