

# The Private Finance Initiative: a policy built on sand

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With 677 Private Finance Initiative projects worth £42.7 billion already commissioned and many more in the pipeline, government commitment to PFI could not be clearer. The scale of PFI projects has been matched by the volume and variety of its critics, spurred on by its high costs which have resulted in cuts in services, public exposure of PFI failures and the flaws in the argument.

The UK Government accepts that private finance is more expensive than conventional procurement, but argues that the extra costs of private finance are offset by the transfer of risk and responsibility for performance to the private sector. According to the Treasury, "the private sector is better able to manage many of the risks inherent in complex or large scale investment projects than the public sector."<sup>1</sup> Savings in the costs of construction make it cheaper than traditional, publicly financed procurement, because the incentive structure of PFI whereby private firms risk losing their own money, brings benefits that outweigh "any cost involved" in using private finance.<sup>2</sup> Among the alleged benefits of private financing are savings due to the reduced incidence of cost and time overruns when construction projects come in over budget or late.

UK Government procurement policy rests on Treasury claims that PFI has reduced both the **frequency** and the **magnitude** of cost and time overruns. According to the Treasury document *PFI: Meeting the Investment Challenge*, 2003: "PFI projects are being

delivered on time and on budget. HM Treasury research into completed PFI projects showed 88 per cent coming in on time or early, and with no cost overruns on construction borne by the public sector. Previous research has shown that 70 per cent of non-PFI projects were delivered late and 73 per cent ran over budget."<sup>3</sup>

These data have been used by the Government to face down criticisms of the policy, to inform the Treasury's guidance on PFI appraisal, and to support the whole of government public-private partnership (PPP) policy both in the UK and abroad. More importantly, the data are now incorporated into government guidance. For example, the revised Treasury Green Book, which lays down the rules for evaluating public procurement, requires that all estimates of construction costs in non-PFI schemes are inflated by up to 24% to take account of the risk of cost underestimation and the risk of works taking longer than scheduled. This makes the PFI projects appear to be better value for money.

The UK Treasury cites five research studies as the source of the cost and overrun data. However, the reports themselves acknowledge limitations to the data, that both the Treasury and the NAO ignore. We have recently conducted an evaluation of the five reports which highlights the following deficiencies in the evidence base:

Two of the five reports were based on surveys and consultations with project managers and contain no primary data on cost and time overrun. [National Audit Office

reports; *Modernising Construction* (2001) and *PFI Construction Performance* (2003)].

A third study was designed to develop a method, not to evaluate cost and time performance and has no data on cost and time overrun performance. [Agile Construction Initiative: Benchmarking Stage Two Study (1999) cited by NAO]

The Treasury's own report contains no data to assess cost and time overruns and its methodology is not in the public domain.

The fifth study, conducted by Mott MacDonald, a company which acts as a technical adviser on PFI deals, does have data but it is methodologically so flawed and statistically so biased that the conclusions are uninterpretable.

The Mott MacDonald Report is the only comparative study of PFI versus conventional procurement. But our evaluation of the data revealed four categories of serious error:

**Sample bias.** Although 500 PFI deals had been signed at a value of £28 billion, the Mott MacDonald sample was restricted to 11 PFI schemes and 39 non-PFI schemes of which only three PFI and seven non-PFI were standard building schemes. The sample is small and not representative of procurement schemes as a whole. There were too few cases to compare costs and time overruns.

**Selection bias.** The selection of cases under each procurement route was not done on a like for like basis. Non-PFI schemes were over-represented by unusual and atypical schemes compared with PFI. For example the PFI sample excluded high profile IT and other failed PFI schemes.

**Policy time period bias.** The conventionally procured project sample includes projects commissioned under much earlier and different policy guidance periods, sometimes several decades earlier, than for PFI projects. They therefore do not benefit from significant improvements to procurement that have been made since.

**Bias in baseline measures** for cost and time overruns. PFI costs and

time overruns were measured at a much later stage in the procurement process than Non-PFI. This has resulted in Non-PFI costs being artificially and wrongly inflated compared with PFI.

The Treasury objective of having "a sound evidence base" for and a "rigorous investigation" of PFI has not been fulfilled. More than 600 PFI projects with a combined capital value of £42.7 billion have been approved or completed but

the chief justification for the policy, that it is value for money, is not supported. The data are being applied in the guidance and used in the policy process despite their evident shortcomings. The evidence base underpinning Treasury guidance for the appraisal of PFI is unsound.

<sup>1</sup>HM Treasury (2004), *Quantitative assessment user guide*, p. 7.

<sup>2</sup>HM Treasury (2003), *PFI: Meeting the Investment Challenge*, p.109.

<sup>3</sup>HM Treasury (2004), *PFI: Meeting the Investment Challenge*, p.43.