

UNISON Response to the
Select Committee on
Economic Affairs
House of Lords

**Private Finance Projects and
off-balance sheet debt**

October 2009



1. UNISON welcomes the opportunity to give evidence to The Economic Affairs Committee of the House of Lords on the Private Finance Initiative (PFI).
2. As the largest public service union in the UK with 1.3 million members, UNISON has a substantial membership in education, local government and health and UNISON members are directly involved with and employed on PFI schemes.
3. UNISON has had serious concerns about PFI since its inception, including the evaluation methodology used for PFI, the impact on public services and the public finances. UNISON has collected evidence and commissioned expert research on PFI, in order to support our case with evidence and clear argument.
4. A key issue for UNISON is how PFI impacts on the workforce and we would like to take this opportunity to raise issues on this to the inquiry, even though it was not one of the questions identified in the call for evidence. PFI is about services and the workforce is therefore central to their operation, and to the quality of the services provided.
5. The government has always been clear that PFI is not just about procuring assets: *“Private firms become long term providers of services rather than simply upfront asset builders, combining the responsibilities of designing, building, financing and operating the assets in order to deliver the services demanded by the private sector”*¹ (HM Treasury 1997)
6. But this committee is not alone in overlooking workforce issues – a trip to the web sites of the Office of Government Commerce (OGC) or Partnerships for Schools (PfS), for example, will reveal the same omission, with no clear and upfront policy on handling workforce issues in PFI schemes, despite the fact that they provide and oversee procurement advice for major programmes of PFI and other projects.
7. The Treasury has a strong policy on workforce matters in PFI: *“PFI has allowed for considerable innovation in workforce practices, but the value for money that PFI can deliver should not be achieved at the expense of staff terms and conditions. The Government has taken a range of steps to strengthen worker protection and ensure the fair and reasonable treatment of those working under PFI contracts.”*² HM Treasury 2003
8. Regrettably, the Treasury has never checked whether their policy is working, nor whether their modifications have indeed meant that “PFI does not come at the expense of the workforce”.
9. *“Going forward, the Government is also committed to monitoring the implementation and performance of measures taken to avoid new joiners to PFI workforces receiving worse terms and conditions than do transferred staff, as this will be key to establishing future best practice. It is important that the principles behind the code, workforce protection and adequate flexibility to deliver high quality public services, are achieved.”*³ HM Treasury 2003
10. A 2004 NAO study⁴ on staff protections in PPP/PFI deals showed the existence of two tier workforces in PFI. A two tier workforce is where a contractor increases profits by hiring new joiners on lower pay and conditions than staff who transferred to them from a public authority under the TUPE regulations, which protect their terms and conditions at the point of transfer. The study was undertaken in 2004 and preceded the introduction of a range of workforce protections so UNISON would welcome another study that could produce more up to date evidence of what is happening to staff on PPP/PFI projects.

1 HM Treasury 1997, Fiscal Policy: A New Framework For Public Investment

2 HM Treasury 2003, PFI: Meeting the Investment Challenge

3 Ibid.

4 NAO 2008, Protecting staff in PPP/PFI deals

11. In the meantime the workforce in PFI contracts are at risk of a downward spiral of their terms and conditions which inevitably impacts on the quality of the services that they provide⁵.

Question 1: How should the cost and benefits of Private Finance projects be assessed?

12. It is difficult to assess the costs and benefits of PFI relative to conventional procurement because of the inbuilt bias towards PFI in the evaluation process and general lack of information. UNISON published a powerful critique of the Treasury's methodology for evaluating PFI projects, "The Private Finance Initiative: A Policy Built on Sand"⁶ and UNISON's report, "Public risk for private gain?"⁷, emphasised the general absence of financial auditing of actual risk transfer absorbed by PFI contracts and the cost that this involved.

13. PFI schemes should be compared with a public sector comparator (PSC) to ascertain value for money. But the methodology currently used 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 open to manipulation, bearing in mind that there is no alternative to PFI for major investment. Indeed the evidence 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. They may get a subsidy (such as PFI credits in English local authorities) or, as in Scotland, the block grant system of funding devolution (the 'Barnett formula') provides a perverse incentive to use PFI so long as it can be kept off balance sheet.

14. UNISON has called on the government to undertake a comparative and independent review of PFI to establish the costs of PFI projects and to ascertain whether they have an effect on the wider economies within which they operate.

15. UNISON remains convinced that the desire to keep capital borrowing off the public sector balance sheet is still a driving force for PFI that takes precedence over the growing evidence of lack of risk transfer and escalating costs. A policy that looks increasingly irrelevant, given the record borrowing that has taken place in order to deal with the banking crisis.

16. At the very least, UNISON would like to see genuine choices of investment models for public infrastructure and the removal of soft services such as cleaning, catering and portering from PFI contracts.

Question 1: Is enough information disclosed on Private Finance projects fully to assess whether the taxpayer is getting value-for-money?

17. UNISON branches and local communities find it very difficult to access information on major PFI projects involving many millions of pounds of public money that impact on their services and jobs. This stifles consultation and debate on key public policy decisions. Even with the Freedom of Information Act vital information is often withheld, citing "commercial confidentiality". PFI derivatives such as LIFT in NHS primary care and Local Education Partnerships in English schools, are one step further removed from communities and the workforce and make meaningful information flows and consultation even more difficult to achieve.

⁵ UNISON has published studies that demonstrate clearly how competition has reduced the quality of the services. The Treasury concluded that "the evidence on satisfaction with soft services does not demonstrate value for money as consistently as other elements of the framework.."

⁶ UNISON, 2005 The Private Finance Initiative: A Policy Built On Sand

⁷ UNISON, 2004, Public risk for private gain?

18. The difficulties in accessing relevant information are illustrated by one persistent UNISON branch for whom it took from September 2006 until April 2009 to get hold of a reasonably, redacted version of the Full Business Case (FBC) for their hospital PFI scheme from the Mid Yorkshire Hospital NHS Trust. Furthermore the branch struggled just to get their case prioritised by the Information Commissioner's Office (ICO). They were, not surprisingly, especially interested in information on staffing. Their first complaint to the Information Commissioner was in September 2007 following which they received an extremely redacted copy of the FBC in December 2007 which they referred back to the Commissioner. The Commissioner was unable to allocate a case officer to this complaint but by April 2008 had got the Trust to conduct a review of the application of exemptions to disclosure and an agreement to release "a substantial amount of the previously redacted information". In May the Trust issued 2 out of a total of 63 documents deemed 'commercially confidential' – one relating to the UK Treasury Gilt rate and another to a Trust board meeting of November 2004. It was not until October 2008 that the Commissioner was able to allocate a case officer and a final agreement on the release of a fuller redacted version of the FBC was reached in April 2009. There is still a separate case pending for the release of important financial data.
19. In a recent case, waste company Veolia Environmental Services took out an injunction to prevent Nottinghamshire County Council disclosing details of a £850million, 26 year waste project which had the effect of also preventing the established public access to the council's annual accounts. The case has now been resolved and will hopefully set a new benchmark for disclosure.
20. UNISON believes that private bodies providing public services, and therefore in receipt of taxpayers money, should be subject to the same scrutiny and accountability checks as public sector bodies. The public has a right to know about the costs and quality of a public service, irrespective of which body is providing it. UNISON is disappointed that a recent government consultation on extending the FOI Act to all bodies undertaking public services made little progress. The government rejected a recommendation from the House of Commons Public Accounts Committee to bring privatised public services within the scope of the Act, after heavy lobbying from the CBI.
21. These projects are of significant public interest, and involve large sums of public money and decisions that will impact on communities for decades to come. UNISON would therefore like the Information Commissioner to take a proactive role in encouraging full disclosure of information on PFI and other major outsourcing projects and to prioritise complaints when this information is not forthcoming and notes that the Scottish Information Commissioner has taken a much stronger line on these issues.

Question 2: How does the performance (e.g., cost, delivery dates and service quality) of schools, hospitals, prisons, roads and other projects operated under private finance compare to those which were traditionally procured?

22. There is a growing body of evidence that PFI is costly, complex and inflexible, and does not provide high quality of services.

Cost

23. A recent study⁸ concluded that soft services provided by PFI hospitals are more costly and at a lower quality than non-PFI hospitals. The study cites an unpublished report by the National Audit Office (NAO), compiled in 2007, that compared the cost and quality of security services; linen and laundry services; portering and cleaning services in the first wave of PFI hospitals and non-PFI hospitals, and showed that all four services were

8 Centre for International Public Health Policy, August 2009, The experience of the private finance initiative in the UK's National Health Service, Moritz Liebe, Prof Allyson Pollock

cheaper and of better quality in non-PFI hospitals. Security cost £3.13 per sq m in PFI hospitals compared to £3.03 in non-PFI hospitals. Linen and laundry services had a cost of £8.44 per sq m in privately financed hospitals, but only £7.64 for those where procurement was traditional design and build. The cost for cleaning services was £22.77 per sq m in PFI hospitals and only £20.47 in the others. Cleaning services were highlighted as poor and more expensive, with 41% of clinicians reporting that the level of service was “poor” or “very poor”.

24. The most corrosive effect of PFI comes from its huge cost. In 2008 a study by the Manchester Business School⁹ concluded that the additional cost of private finance for the first 12 hospitals was about £60m a year, which is 20-25% of the Trust’s income, creating serious budget inflexibilities for the Trusts. The higher costs of PFI often lead to affordability gaps, which have to be met by the public purse. This in turn puts pressure on jobs and the quality of services and have a knock on effect on non-PFI services.
25. UNISON’s report “Reclaiming the Initiative - putting the public back into PFI” (June 2009) looked at how billions of pounds of public money have become locked into financing expensive PFI schemes. It warned that the Government has committed taxpayers to a bill of more than £217bn in ‘user charges’ for PFI schemes with a capital value of just £64bn, between now and 2033/34. Public funding and ownership could save as much as £3bn per year. There is also evidence that when services come up for review they are adjusted upwards. In 2007 a Public Accounts Committee report cast doubt on the competitiveness of PFI reviews and showed that ‘benchmarking and market testing’ prices during the contract increased prices by up to 14%.

Quality

26. PFI has an impact on the functioning of hospitals and schools. There are examples of poor quality services; cuts to services and jobs; and hospital wards and schools closing. Many of the early PFI schools were blighted with design problems and are of poorer quality compared to traditionally procured buildings¹⁰. But the situation has not fared better for newly built schools procured under the Building Schools for the Future Programme (BSF), which is partly funded by private finance. Recent evidence suggests that PFI schools continue to suffer from a catalogue of problems, including chronic overheating, leaking roofs and inadequate facilities. In 2007 the Association of School College Leaders (ASCL) published a critical report on PFI schools which highlighted design and contractual problems, estimated to cost the taxpayer billions of pounds. Head teachers have complained that PFI contractors provide a poor service and put up their fees, and have expressed concerns that time that should be spent on education is being wasted on resolving contractual problems.
27. In August 2009 the Commission for Architecture and Built Environment revealed that more than 104 Building Schools for the Future schemes were rated “not good enough”, “mediocre” or “poor”. And more recently data obtained by the PPP Bulletin¹¹ under the Freedom of Information Act shows that the costs for the scheme have grown. For example, 31 councils have seen the expected costs for their schools rise from an initial £122m to £161m.

Inflexible

28. PFI locks the public sector into inflexible contractual arrangements for up to 30 years, with little room for variation. This can be seen in the case of Balmoral High School in Belfast which was built in 2002. Demographic changes meant that by 2007 school was no longer

9 Public Money & Management, April 2008, 'The Cost of Using Private Finance to Build, Finance and Operate Hospitals' Jean Shaoul, Anne Stafford and Pam Stapleton

10 Audit Scotland June 2002, Taking the initiative - Using PFI contracts to renew council schools

11 PPP Bulletin, 11 September 2009, Costs Building Up

needed, but because it was built under PFI, the council is committed to paying £9.2m in maintenance every year for the life of the contract.

29. Making day-to-day changes in PFI buildings can be extremely difficult and expensive. A National Audit Office report published in 2008 found that £180m a year is paid out to PFI contractors for contractual amendments. It reported major variations in charges for what was often routine maintenance work, which had failed to be specified in the original contract. While one school had to pay £320 to fit a new electric socket, elsewhere the charge was £30.81. It is the unique contractual position of PFI contractors that means that small changes can involve large adaptations to contracts as well as virtual monopoly pricing.

Question 3. Is there significant risk transfer to the private sector or is it more apparent than real?

30. The underlying principle of PFI and PPP is that risk is transferred from the public to private sectors and yet there is no comprehensive evaluation or independent research on the actual risks of PFI contracts. UNISON's report "Public risk for private gain?" (July 2004) illustrated the often illusory nature of risk transfer of PFI and PPP schemes.
31. Failed PFI contracts, on too many occasions, have had to be rescued by the public sector meeting additional costs. The failed Metronet PPP went into administration just four years into its £17bn contract to modernise two thirds of the London Underground and the failure has cost the taxpayer £410m.
32. The current economic climate is leading to huge pressures on contracts and pressures on PFI companies leading to the collapse of a number of PFI schemes. Companies that got into serious problems in the past include Jarvis, Ballast, Melville Dundas and Metronet. Recent projects facing severe problems include the Defence Animal Centre, a project for 29 Cornwall schools and the collapse of William Verry a facilities management contractor for Hackney Council's secondary schools. In theory, the special purpose vehicle should replace a failing company and there should be reasonable continuity for the public authority. In practice they face higher charges as in Tower Hamlets and Cornwall, where the financier and investor, Abbey and Innisfree, both withdrew, leaving the councils to pick up the pieces.
33. The public sector generally retains demand risk – the number of patients or prisoners or pupils – with the result that if demand changes, the public sector again picks up the bill. A number of PFI schools have had to close due to falling pupil numbers, leaving public bodies with huge financial liabilities. When the newly built Comart and Media Arts School closed in Brighton after pupil numbers halved, Brighton Council had to pay PFI contractors £4.5m for terminating the PFI deal. And, NHS Wandsworth is faced with costs upwards of £350m for the Roehampton PFI Queen Mary's hospital which cost £73m to rebuild, due to the hospital using more services than planned. The high level of repayment is likely to impact on future health services. Without PFI, the long term costs of adapting to significant changes in demand would be much more manageable.
34. In refinancing deals, the public sector can end up with more risk, without commensurate reductions in their charges. At the Norfolk and Norwich University Hospital Trust the PFI consortium made a windfall profit of £115m and increased their annual rate of return to investors from 19% to 60%. The new deal left the hospital with a longer contract and greater potential liabilities of up to £273m, if the contract was terminated early. The deal was described by the Commons' public accounts committee as "the unacceptable face of capitalism."

Question 7: Would public sector investment in the last decade have been lower without Private Finance? If so, by how much?

35. No. The decision to use private finance is a political decision and the credit crisis has amply demonstrated that when a government decides to borrow very large sums, it is well able to do so. Governments have chosen to use the private sector as an intermediary for their borrowing for infrastructure projects and to bundle in services rather than provide much cheaper funding through public borrowing.

Questions 8 and 9 together:

Question 8. How much impact has the financial crisis had on launching new Private Finance projects? Is the crisis likely to have a permanent effect on the Private Finance market?

Question 9: Are there realistic alternative roles for private finance than the current PFI-type private finance models? Should the UK be aiming for more diversity in private finance models? Would a national infrastructure bank (such as the proposed Dodd-Hagel NIB in the US) add any value in the UK? Should the public sector have a more hands-on role in financing and/or delivery?

36. UNISON's report "Reclaiming the Initiative: Putting the Public Back into PFI (2009) shows how the reliance on private finance for public sector projects has exposed them to greater hazards and weaknesses as the financial crisis has deepened. The report proposes a move towards a publicly funded, design and build programme which will ensure a more efficient and more flexible and ultimately more cost effective way of building public infrastructure. The key elements are to:

- By-pass the market restrictions currently holding up projects, by using direct investment, with publicly funded design and build schemes
- Remove soft services – such as cleaning and catering from existing PFI deals. This would be in line with an increasing body of evidence that they do not represent good value for money. In 2006, the Treasury toughened the criteria for including soft services, though it did not ban it outright. Then, in 2007, an NAO report found there was no evidence that including services within PFI contracts was better value than keeping them in public hands
- Gradually bring existing operational PFI contracts into public ownership and halt further waves of PFI schemes.

Conclusion

37. PFI has never been a successful policy, but has escaped the critical attention it deserves, through the superficial appeal of the notion of a partnership between public and private sectors, that fits so well with the political consensus that the private sector can deliver public services most efficiently.

38. The credit crisis has changed all that. As one of PFI's foundations, bank credit, begins to look increasingly shaky, a light is thrown on the wastefulness and inefficiency of the whole initiative and the tide of opinion is turning against it.

39. The smart use of conventional procurement, in the hands of a more savvy public sector, would be one step in the transformation of public services, ensuring they were run by the public sector for the benefit of the public, rather than for private profit. PFI has been a long and wasteful experiment, and it is time to bring it to a close. We should look forward, instead, to a more efficient, more flexible and ultimately more 'value for money' way of building roads, schools and hospitals, that we as a public need.

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