BMJ 2018;360:k311 doi: 10.1136/bmj.k311 (Published 25 January 2018)

EDITORIALS

Failure of the private finance initiative

Was predictable and predicted

Richard Smith *chair and former The BMJ editor in chief (1991-2004)*

icddr,b, Dhaka, Bangladesh

In 1999 *TheBMJ* called the private finance initiative (PFI) "perfidious financial idiocy,"[1] and in 2017 the Office for Budget Responsibility described it as a "fiscal illusion."[2] Now a data driven report from the National Audit Office shows that PFIs have been more expensive than the use of public financing for the building of hospitals, schools, and other public buildings and has mostly not realised the benefits hoped for.[3] Published in the same week as the collapse of Carillion, a large company fulfilling PFI contracts, the report has helped propel private financing and provision of public services high on the political agenda.

The difference between conventional public procurement of new buildings and PFIs lies in the financing. In both cases private contractors do the work, but with PFIs the money comes from the private sector. The public sector then pays back the private sector over some 25-30 years from when the building is delivered. The UK has over 700 PFI projects with a capital value of around £60bn (€68bn; $83bn). Annual charges were £10.3bn in 2016-17, and even without any new projects charges will continue into the 2040s and cost £199bn. It's important to note, however, that over the past 20 years the contribution of PFI, at around £3bn a year, is relatively small compared with public capital investment of around £50bn a year.[3]

The main attraction of PFI to the government is that privately raised capital does not add to national debt. Nevertheless, it is paid for from the public purse in the form of annual charges, and the Treasury knew when it launched PFI in 1989 that it would be more expensive because privately raised capital is more expensive than publicly raised capital and carries other costs (insurance and management costs). It hoped, however, that it would achieve value for money through efficiencies and better outcomes. The National Audit Office report dashes those hopes.

Even the National Audit Office does not have access to all the government's PFI contracts, but its study of a group of schools found that PFI costs are about 40% higher than funding with public money. A study in 2011 by the House of Commons Treasury Committee found that a PFI hospital cost 70% more than a publicly financed one.[4] The Treasury disputes these findings.

Save now, pay later

PFI is also attractive to government ministers because there are savings in the early years: the costs come later. The National Audit Office's study of the schools showed that despite the overall costs being higher, costs were lower for the first 15 years. The Department of Health had greater flexibility in its budget between 1997 and 2009 because the capital investment was greater than the charges, but by 2015 charges were almost £2bn greater than capital investment. This lack of flexibility is much more severe in some NHS trusts, with one trust paying 20% of its turnover in PFI charges.[3]

The National Audit Office analysed the hoped for benefits to see if they outweighed the extra costs. It found that PFI projects are more often delivered on time and within budget than non-PFI projects but did not find any savings in construction costs. Similarly, it found no evidence of operational efficiencies, and there were higher maintenance costs in PFI hospitals but also higher standards.

Lack of flexibility may prove to be one of the biggest problems with PFI projects lasting 25-30 years. The report describes how Liverpool City Council is paying £4m a year for a school that is empty; overall it will pay £47m for a school that cost £24m to build. Most observers of the NHS recognise the need to shift services from hospitals to the community.[5] Inflexible, long term PFIs preserve the domination of hospitals at the expense of community services.

Health authorities and local authorities have, however, now recognised the idiocy and seen through the illusion: between 2002 and 2007 there were an average of 55 PFI deals a year, whereas there was only one in 2016-17. Nevertheless, the public sector will be paying average charges of £7.7bn over the next 25 years, and the National Audit Office concludes that it is difficult to reduce the costs.

Despite the criticism of PFI since its inception, the overall performance of PFI has never been quantified. In the face of higher financing costs and continuing criticism, the Treasury relaunched PFI as PF2 in 2012, but the National Audit Office concludes that it's not much different—hence the low uptake. Yet the poor state of the nation's finances means that there may have to be some continuing use of PF2.

richardswsmith@yahoo.co.uk

The combination of the National Audit Office report and the collapse of Carillion has led to calls to end all use of the private sector for providing public services, but this would probably be a mistake. The *Financial Times* points out that if there is a market in the service, performance can be easily measured, and the service isn't integral to the purpose and reputation of government, then outsourcing to the private sector can work.[6] Catering meets all three criteria, whereas probation services meet none of them.

The public sector should be smart rather than ideological and avoid the illusion of a "free lunch," as *The BMJ* said in 1999.[1]

Competing interest. RS wrote the 1999 editorial on PFI, when he was editor of *The BMJ*. He worked for UnitedHealth Group, a private company supplying services to the NHS from 2004 to 2015 and still has shares in the company. He is also the chair of Patients Know Best, a private company selling into the NHS. This position is unpaid but RS owns share options (about 1% equity) in the company. He is also a paid consultant for an artificial intelligence company Medial EarlySign, which hopes to sell into the NHS.

Provenance and peer review: Commissioned; not externally peer reviewed.

1 SmithR. PFI: perfidious financial idiocy. a "free lunch" that could destroy the NHS. BMJ1999;319:2-3. doi:10.1136/bmj.319.7201.2.10390430
2 Office for Budget Responsibility. *Fiscal risks report*. 2017. http://obr.uk/docs/dlm_uploads/July_2017_Fiscal_risks.pdf
3 National Audit Office. *PFI and PF2*. 2018. https://www.nao.org.uk/report/pfi-and-pf2/
4 House of Commons Treasury Committee. Private finance initiative. 17th report of session 2010-12. 2011. https://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/1146.pdf
5 Commission on the Future of Health and Social Care in England. A New Settlement for Health and Social Care.King's Fund, 2014.
6 Maddox B. The collapse of Carillion is not an argument to end outsourcing. *Financial Times* 2018 Jan 20: https://www.ft.com/content/3ef53b22-fc47-11e7-9bfc-052cbba03425