Should the private sector be involved in providing public services?

There was a bad reason for the Private Finance Initiative, and several good reasons.

The bad reason was much used under the Blair/Brown Labour government. They wanted to pay for a number of new schools and hospitals without the capital cost appearing on the public accounts. They therefore asked the private sector to borrow the money to keep it off the government balance sheet. The government can usually borrow more cheaply than private sector businesses. Bad PFI contracts sometimes resulted, with the state simply paying more to borrow through the intermediation of a PFI contract. In practice much of the risk of the projects rested still with the taxpayer who could end up with a bad deal.

The good reasons for PFI are that the private sector can do come things better and more cheaply than the public sector by specialising and managing them well, and the private sector can take on risks that would otherwise fall to the taxpayer. When the Thatcher government first got interested in the idea of more private sector help in delivering public sector projects and services it developed a set of rules.

Where the private sector wanted to provide a regular service by employing the staff and managing the tasks, the public sector had to organise fair competitions for the work and had to demonstrate there would be savings over the contract period compared to doing the work in house. When Councils and the central government contracted out items of service like refuse collection, cleaning and catering, there were usually substantial savings and a tough better policed standard of service required. The private contractor was on risk for managing the task and the staff, and faced penalties for failure to deliver the required quality and quantity of service. The public sector still had important roles in deciding how much service it needed, what the standard should be, and in policing the contract.

Where the government wanted the private sector to undertake the financing and delivery of a major capital asset there had to be sufficient transfer of risk to make it worthwhile for the public sector. The UK public sector has in the past had a poor record of controlling the costs of major projects and delivering them on time, though the current government believes it has sorted out many of these difficulties. A design, build, and finance contract for the private sector clearly got over any risk of expensive overruns and delays for the taxpayers. The extra cost of capital that the private sector would incur could be more than offset by better discipline in how long it took to build and how much it cost to build. If the private sector was unable to cut costs as it thought then it was on risk to absorb the overruns. One of the most successful examples of a design, build, finance and operate contract was the Dartford crossing. The private venture was allowed to charge a toll and to collect it for as long as it took to recoup their outlay and an agreed profit. The bridge then passed to the state without debt as a free asset. The private sector still had plenty of incentive to build to budget and to get on with generating the cashflows, as investors wanted an early pay back.

It would be wrong to drop the involvement of the private sector in the provision of public services as well as impractical, just because one large company involved in public provision has gone bankrupt. It is important that shareholders, bondholders and lending banks are not bailed out by taxpayer money, which the government has been clear it will not allow. For the system to work there have to be penalties for the private sector for error and failures. The story when told will probably show us that the private sector became too keen to take on public sector business at very low margins, which turned out to be loss making when they came to manage the risks they had willingly accepted. Private shareholders have ended up subsidising the state as a result by supplying services and facilities below cost.

As a Minister I did turn down a proposal for a PFI project on the grounds that it was primarily a way of paying more for borrowing and substituted a public sector project. I took the rules seriously, and wanted to see there was either or both a significant transfer of risk or clear evidence that good quality provision would be cheaper through PFI. That should continue to be the guidelines for the UK government and Councils. Labour’s attack on all of this is absurd, given the big role the last Labour government played in extending PFI and contracting out, and given the extensive use Labour Councils rightly make of these techniques today. One of the curious features of Labour in office in recent years locally and centrally is the way they have come to rely very heavily on private sector contactors and sub contractors to deliver public services. Much local policy making relies heavily on private sector consultants rather than on officers of Councils, and it was Labour who also introduced the idea of private sector healthcare performing operations for the NHS.