PFI in Education

A Dossier

Table of contents

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Private companies are set to cream millions in profits from a growing number of contracts to rebuild, refurbish and provide support services to schools in England, Scotland and Wales under the government's controversial Private Finance Initiative.

In England alone 30 deals to provide and service school buildings valued at £800m are set to generate payments well in excess of £2 billion for private sector consortia, which include John Laing, Balfour Beatty, WS Atkins, Interserve and Jarvis, along with major British and European banks. The total "market" for the private sector in education has been estimated to be as high as £5 billion a year. [1] [2]

More schemes are in the pipeline, as school and council officials go through the elaborate legal processes of drawing up binding contracts, most of which will run for 25-30 years.

In Scotland, PFI deals covering school modernisation totalling over £400m include the massive Glasgow City council scheme for 29 schools, which will involve an investment of around £220m and generate around £1.2 billion in rental and service payments to the consortium over 29 years.

What is PFI?

The initials stand for **Private Finance Initiative**: PFI is a Tory policy, first devised in 1992, which was strongly denounced by Labour's shadow ministers until a few months before the 1997 election.

According to Tory Chancellor Kenneth Clarke, who introduced the policy, PFI means:

> **"Privatising the process of capital investment in our key public services, from design to construction to operation."**

His Scottish Party colleague Michael Forsyth, launching the scheme north of the border, also welcomed the fact that PFI would give the private sector "scope for higher profits". [3]

[1] Like bees round a honeypot, Times Educational Supplement (TES) December 19 1997
[2] Can schools survive commercial drive? *Observer* February 111 2001
[3] Michael Forsyth, A Partnership for Scotland, quoted in Scottish Parliament by Kay Ullrich MSP, June 24 1999

At first Labour's shadow cabinet rejected PFI as "the thin end of the wedge of privatisation". But in the summer of 1996 Shadow Treasury minister Mike O'Brien announced a change of policy:

> **"This idea must not be allowed to fail. Labour has a clear programme to rescue PFI."**[4]

By the spring of 1998, PFI was:

> "A key part of the Government's 10 year modernisation programme for the health service."[5]

According to ***Guardian*** financial columnist Larry Elliott, PFI is "a scam":

> "Of all the scams pulled by the Conservatives in 18 years of power – and there were plenty – the Private Finance Initiative was perhaps the most blatant. ... If ever a piece of ideological baggage cried out to be dumped on day one of a Labour government it was PFI."[6]

How does it work in education?

In short, large-scale building projects, which would previously have been publicly funded by Treasury revenue support grants to local authorities, are now to be put out to tender, inviting consortia of private banks, building firms, developers and service providers to put up the investment, build the new school or group of smaller schools, and lease the finished buildings back to the Local Education Authority – generally with non-teaching support services (maintenance, caretaking, cleaning, sometimes catering, etc.). This is the classic PFI project: Design, Finance, Build, Operate (DFBO).

Since 1999, however, government guidance has opened the possibility of excluding support services from schools PFI: indeed the government suggests that such services should only be included if a separate value for money case can be made for doing so.

But though at least one high profile scheme (Stoke on Trent) has been signed as a DFB project (Design, Finance, Build), the private sector is keen to keep support services as part of the potential revenue stream flowing from PFI.

While the list of (generally much larger) PFI projects in the NHS have tended to gain a higher profile in media coverage, PFI in schools has been gathering pace. In July 2001, Education minister Stephen Timms announced in Parliament that a total of 56 schools PFI projects had been approved by the Department and Treasury Project Review Group, of which 30 had reached commercial and financial close: 1 in 1997-98, 6 in 1998-99, 9 in 1999-2000 and 14 in 2000-01[7].

The first school built under PFI was the small Victoria Dock Primary school in Hull: the first larger school, Colfox comprehensive in Dorset, opened in 1999.

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[4] (*HSJ* 22.8.96).
[5] (DoH Press Release 7.4.98).
[6] (The Guardian, October 26 1998
[7] Hansard, 20 July 2001

Negotiations on the PFI deal to build Colfox school had dragged on for years, during which the estimated price rose from £9.5m to £15.6m. Finalising the contract cost almost £500,000 in consultant fees and officer time. Now the unitary payments to the PFI consortium will consume a massive 12% of the school's projected income, and even the most optimistic presentation of the deal shows a claimed saving of just £400,000 (less than 2%) over the 30 year contract against a (hypothetical) public sector comparator.

PFI in education works differently from NHS schemes. NHS Trusts, since the Tory government's "market" style reforms of 1991, have to pay capital charges – a notional "rent" on their assets – which are recycled within the NHS, but which in theory can be used to help pay lease charges for PFI hospital facilities.

Schools do not pay similar charges: however they have to seek capital via their local authority, which unlike an NHS Trust or health authority is itself allowed to borrow money. The government makes an allocation towards councils' capital spending through the Revenue Support Grant, and to give a clear hint of the direction they wish councils to move, the allocations for school improvements have been called "PFI credits".

The affordability gap

Under the system of PFI credits, councils are – in theory – reimbursed by the Treasury for the capital element in the scheme, leaving the council to cover 30% of the costs which are assumed to be the revenue costs of running the school, which they would have had to pay anyway.

However this system almost inevitably results in a gap between the government funding and the actual expenditure on a local project – a gap which the council is expected to find ways and means to bridge, either by finding more money, or (more commonly) by cutting services and squeezing other budgets. The London Borough of Haringey has had to bridge a gap of £13.8m from other budgets in order to make its schools PFI scheme affordable. [8]

Wiltshire has wound up with a £400,000 a year gap on the funding of its £125m schools PFI – a problem for the next 30 years. Staffordshire and Derbyshire are also struggling to bridge affordability gaps, while the Colfox school faces a budget shortfall of £6,000 a year. [9]

The £225m 29 year Glasgow schools PFI (total cost £1.2 billion) has had to be subsidised by a massive £17m a year so-called "level playing field" payment from the Scottish Executive, and the Falkirk schools scheme was only affordable because of a hefty £8m a year subsidy from the same source.

[8] *Public Services, Private Finance*, UCL School of Public Policy, for UNISON 2001

[9] Private sector pot of gold turns into mirage, Jon Slater, TES 8 June 2001.

The guidance for local councils on, drawn up by the Public Private Partnership Programme (4Ps), a company set up by the government to promote PFI projects in local government, points out that:

> "Unless the project is financially free standing, there will be a cost to the local authority of all schemes procured through the DFBO mechanism." [10]

And in its companion text on PFI credits, the 4Ps warns that because of the peculiar way in which the PFI credit is calculated, which does not match the way in which the council will have to pay real cash each year to the consortium:

> "It is evident that some schemes may not recover the full amount of the capital element over a 25/30 year period. ... On an annual basis there will often be a significant mismatch in funding." [11]

This gap can be quite substantial compared to the total bill. A table in the 4Ps pamphlet calculating an example of a PFI scheme shows PFI credits totalling just £7m on payments to the PFI consortium totalling £21m. (ibid.)

The extra costs of PFI

Increased "headline" costs of schemes

As with the NHS, school development projects tend to escalate in price as soon as private sector negotiators get involved.

Birmingham City Council began with a £20m scheme for eight schools, but eventually it rose to a £65m and then a £70m plan for ten schools.

Glasgow City Council started off in 1997 looking for a £40m scheme to refurbish 26 secondary schools and build two new ones, which then mushroomed into a £136m plan to build a dozen new schools and refurbish the rest, and eventually a £220m plan – which will cost over £40m a year for 29 years (more than £1.2 billion).

A profit stream for the private sector

The Department for Education and Skills claims not to know how much money is being made out of schools through PFI and other private sector involvement.

Ministers in England and Scotland have been less than eager to share the details of PFI schemes to allay speculation that consortia are pocketing rates of interest well above the norm. When Scottish ministers were specifically asked that rates of interest payable on PFI and PPP schemes, the reply was a straightforward evasion:

> "An average rate of interest paid to all lenders for the provision of capital is not held centrally. Individual interest rates are matters of commercial confidentiality." [12]

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[10] Options Appraisals and the Outline Business Case, p12, 4Ps website, 2000
[11] Calculating the PFI Credit and Revenue Support for Local PFI Schemes, 4Ps Guidance March 2000
[12] Angus McKay, in reply to Andrew Wilson MSP, Scottish Parliament, May 17 2001

Even the level of payments to be made from the public purse to PFI consortia for particular schemes are kept secret and withheld from M Ps and the taxpayer: as Stephen Timms told Yeovil MP David Laws:

> "As agreed with the National Audit Office, payments to contractors under PFI contracts are commercially [sic] in confidence." [13]

Schools minister Jacqui Smith even claimed that this secrecy i s in the public interest:

> "One of he methods through which local authorities ensure that value for money is achieved is by letting PFI contracts through a competitive tendering process. The value for money achieved by previous schemes, whether as an averag e or for individual projects, could be very useful information t potential bidders, as it would enable them to target their bids. To ensure tat any future tenders for schools PFI projects continue to achieve best value, I must respect the commercial confidentiality of the value for money figures provided by local authorities." [14]

In other words there can be no external verification of these schemes by MPs or the wider public, and no detailed comparison across the board of the claimed "savings" and "value for money" of schools PFI projects. The National Union of Teachers has pointed out that (despite the repeated references to "partnership"):

> "The available guidance offers little scope for the public and stakeholders to engage with local authorities in the first two official stages of the PFI process"

It suggests that:

> "A detailed explanation by local authorities as to what information is held back and why would help to increase transparency." [15]

With such elementary figures withheld it is clearly impossible f or any independent judgement to be made on how much PFI deals really cost, and whether they actually do, as claimed by ministers, represent value for money.

It appears that the rates of return for PFI projects have varied between 10% and 20%. A report by Arthur Andersen and LSE found that the average cost of private capital in PFI projects was 1-3 percentage points higher than public sector borrowing. [16] And the city accountants Chantry Vellacott have warned that simply the higher cost of borrowing via the private sector will add an extra £50 million cost for every £1 billion worth of projects.

An idea of the profitability of PFI is given by the figures from Balfour Beatty, which is involved in schools and other PFI deals. As Observer journalist Nick Cohe n pointed out,

> "It reported last month that PFI projects accounted for 20 percent of sales, but 40 percent of operating profits. In other words, the prudent Treasury is allowing companies to take profits from the taxpayer at twice the rate they can make in a competitive market." [17]

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[13] Hansard July 20 2001.
[14] Hansard November 29 2000
[15] *Disclosure of information and consultation*, NUT website
[16] *Private Finance Initiative and Public Private Partnerships: what future for public services?* Centre for Public Services, Sheffield
[17] Class Struggles, Observer, September 9 2001

Research last year by Labour Research found that companies with large parts of their income derived from the education sector were already performing three times as well as the average company on the stock market. [18]

Laing-Hyder, the consortium which built the new Highlands school in Enfield, admitted that they expected to make between 12-14% on the deal over 25 years. [19] The interest rate paid by consortia on PFI contracts is around 9.5%. [20]

By contrast, base rate is now down to 5%, while the Treasury even in 1999, when interest rates were higher, could borrow money at below base rate by issuing gilts at around 4.5%. The inflated interest rate helps guarantee that the bank or finance house involved in a PFI consortium pockets a healthy profit while – as we will show – advancing cash at little or no long term risk.

The inclusion of services alongside the core capital investment, and the incorporation of these charges into a single unitary payment enables the consortium to expand its profit margins. The Haringey schools project involves capital investment of just £87m, but with services included will cost the Borough £233m over 25 years. [21]

It all makes good business sense for the private sector, while the bottom line still involves the taxpayer picking up the inflated bill. As Sue Sanders of the 4Ps told the *TES*:

> "Education appeals to the private sector because it provides a steady income stream." [22]

Inflexibility of PFI schemes

PFI deals commit the council to renting school buildings and purchasing support services for 25-30 years, despite the near inevitability that requirements for the use of these buildings will change over this period. Any alterations to the building or changes incurring extra cost will have to be undertaken by the school or the council at extra cost over and above the ring-fenced, legally-binding payments to the PFI consortium.

The payments to the PFI consortium will have first call on the limited resources of the school budget, limiting the cope for school governors to take steps to recruit additional teachers or otherwise protect the teaching budget in the event of any future reduction in funding – through falling rolls or other external factors.

Buildings will also only be constructed along lines laid down in contracts:

> "In one case internal viewing windows to a sports hall were omitted by the contractor during the construction phase, although they had been seen on design

[18] *Public Private Partnership: opening up the public private debate*, Janet Sillett, LGIU 2001, p11
[19] Ifs and buts of a private enterprise, TES, 10 November 2000
[20] Nicola Sturgeon MSP, Scottish Parliament Official Report, June 24 1999.
[21] *Private Finance Initiative and Public Private Partnerships: what future for public services?* Centre for Public Services, Sheffield, p5
[22] Deals on funding the future, TES 4 September 1998.

> drawings. It transpired that there was no mention of them in the output specification nor in room data sheets, and that the architect's intentions had no contractual force." [23]

Most PFI schemes include services such as property management, cleaning, heating and maintenance. But these deals also stipulate the hours during which the school premi ses will be available to the LEA: the rest of the time it is open to the consortium to make alternative use of the buildings to raise additional capital.

The rigid contracts and the limited access to the building can restrict the school's ability to use the property freely outside normal school hours, and affect the working conditions of staff, whether they be support staff or teachers seeking access to school facilities.

In Falkirk, according to the council leader David Alexander, the problem is especial ly serious:

> "Not only were PFIs expensive, they have created a number of problems in education that did not exist before. For example, because of problems with access to PFI schools, we have great difficulty meeting the Scottish Executive's directive on community schools. The PFI schools are ours only during educational hours. (...)
> "There are additional charges for out of hours services at PFI schools. Schools that are run by the local authority are flexible – our staff will man the schools after hours. The owners of PFI schools employ all the auxiliary staff, which means there are always problems with extra -curricular activities.
> "For example children's luggage was left in the street after they returned from a field trip because access to the school could not be gained. ...
> "One would envisage individuals using sports and leisure facilities at a community school, but that cause problems in PFI schools, as they are run for profit after school hours." [24]

Even the 4Ps workshop on PFI in schools felt obliged to p oint out some of the inflexibilities that arise:

> "As schools have to pay for certain services over and above an agreed level, short notice bookings of facilities outside core hours may cause affordability problems, so an appropriate procedure for school st aff needs to be established. Several projects feel that the management of such a "cultural change" for existing staff is a major task." [25]

The impact of this on the public sector was summed up by the *Financial Times*:

> "The future cash outflows under PFI/PPP contracts are analogous to future debt service requirements under the national debt and, potentially, more onerous, since they commit the public sector to procuring a specified service over a long period of time when it may well have changed its views on how or whether to provide certain core services of the welfare state." [26]

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[23] PFI In Schools, Update from the first operational schools contracts (October 2000), 4Ps website
[24] Meeting of Scottish Parliament Local Government Committee, May 15 2001
[25] PFI In Schools, Update from the first operational schools contracts (October 2000), 4Ps website
[26] FT July 17 1997

Consultancy fees

Eager to promote PFI deals in education, the government has offered cash help to underwrite the legal and consultancy costs involved in getting schemes off the gro und, both in England, with £1m for preparatory work on five school schemes, and in Scotland, where the amount available is now £5m. [27]

The first school schemes averaged 18 months from initial idea to the award of a contract. As the TES pointed out

> "Education authorities are having to invest significant amounts of officer time in developing projects, while companies incur high initial costs in putting together bids and proposals."[28]

Dorset County Council reckoned to have spent £240,000 on consultant fees and "some £250,000 of officer time" in constructing the deal for Colfox School. However the 4Ps claims that "the same project being tackled now would greatly benefit from standardised documents that were not available then." [16]

The costs affect not only the purchaser – the LEA, school governing body etc – but also the consortium. But the private sector has no intention of absorbing these costs – and no need to when it can effectively name its own price. So as one analyst points out:

> "Bid costs are high and must be accounted for somewhere. This means that in a roundabout way, when a company is successful in its bid, built into the price will be the costs of unsuccessful bids that have been made elsewhere. This is probably one big downside of PPP to the taxpayer."[29]

No scope for smaller projects

The transaction costs involved in setting up PFI deals are high enough to make it unattractive for firms to bid for smaller deals involving refurbishment of single schools or rural areas. As John Henderson, then representing the Private Finance unit of the Scottish Executive (though now seconded to the Scottish FA) told MSPs:

> "Our experience of PPPs is that it is difficult for any scheme that costs under £10 million to £15 million to be viable. It is difficult for the public sector to meet procurement costs and attract sufficient interest and reasonable financing costs from the private sector. To deal with that we are considering bundling schemes." [30]

This also helps explain the pressure in almost every PFI project to increase the scale of schemes, from refurbishment to new build, and from one school to many.

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[27] *PFI Scotland* newsletter, Scottish executive, July 2001
[28] Deals on funding the future, TES, Sept 4 1998

[29] *PPP is here to stay*, Chris McKay, cnm@burness.co.uk
[30] Scottish Parliament, Education Culture and Sport Committee, Tuesday 24 April 2001

Staff sold off

Despite the new guidance issued by the government in 1999, which opened up the possibility of separating the building of a school from the operati on if its services, most schemes do hand over public sector support staff to private contractors.

In Glasgow, the City Council (wrongly) stated that:

> "There has to be a significant transfer to a private sector contractor". [31]

Government policy, however i s that any transfer of staff to the private sector should be subject to a separate "value for money" appraisal, and that cost savings should not be achieved through a worsening of the terms and conditions of current and future staff. Those schemes that do involve a reduction in the number of staff employed should only be compared with a public sector comparator which had also been adjusted to reduce staff numbers. [23]

However the assumption is clearly that staff will in general be transferred to the privat e consortium. As the 4Ps summary puts it:

> "PFI contracts deliver ***services*** to the LEA and the school over a period of time and not just the provision of a building." [32]

To deliver services, the consortium must control staff – and this means the existing sta ff must transfer – or lose their jobs. The assumption in PFI is always that the public sector employees are less efficient and that privatisation will improve services. Where the existing staff have already been shown to be highly efficient and delivering a service that is popular with heads and teachers, this can make matters very complicated.

Councils are clearly not expected to stand by their staff. In Stoke on Trent, where the council wished to retain core services (cleaning, caretaking, catering and grounds maintenance) in-house, they were obliged by the DfEE to explain how the resulting project would represent value for money. [33]

The Business Services Association, giving evidence to the Treasury Committee inquiry into PFI, made it clear that it sees the privatisation of staff as a key part of the strategy for "efficiency" – or profit:

> ""The reality is that we look for savings and some of those savings will come from us employing our own staff on our own terms and conditions," although the BSA adds that not all of these savings are simply due to worse terms and conditions." [34]

According to a 1999 report by the Association of Direct Labour Organisations, PFI schemes in all parts of the public sector are expected to lead to the loss of 30,000 jobs and

[31] *Public Services, Private Finance*, UCL School of Public Policy, for UNISON 2001, p12

[32] 2001, www.4ps.co.uk

[33] *Public Services, Private Finance*, UCL School of Public Policy, for UNISON 2001, p13

[34] *Public Private Partnership: opening up the public private debate*, Janet Sillett, LGIU 2001, p23

the transfer of a further 150,000 public sector workers – many of them in low-paid support services – to private contractors in the ten years 1998 -2007.

School PFI programmes in Scotland threaten the privatisation of thousands of non - teaching jobs. In Glasgow alone 500 janitors, cleaners and technicians could find themselves transferred to private contractors.

One of the ministerial advisors promoting PFI in education, seconded from Arthur Andersen accountants, argues for a much more radical privatisation o f school support workers, with the hiving off of "back office staff". Graham Walker told the TES:

> "I believe that schools will be putting all their back office services into the private sector within a few years – and if you have one company service 200 or 300 schools, the whole thing could work much more efficiently." [35]

The idea of school secretarial and administrative work being processed through a handful of remote call centres may bring a gleam to they eye of profit -seeking companies, but it is unlikely to impress hard-pressed parents and those seeking any public access and accountability to school issues.

How does PFI show "value for money?

Private sector "innovation" versus public sector

The 4Ps literature claims that in PFI school projects:

> "The standards of design, construction and operation are noticeably higher than in most conventional schools, because operators are sensibly investing money in quality at the front end to mitigate the cost of putting problems right later."

The DfEE's own guidance also assumes that:

> "The private sector can bring new and innovative ideas to public sector projects." [36]

But this simply exposes the extent to which the private sector – building firms and architects – who have always carried out school projects h ave routinely ripped off and failed to deliver quality buildings in the past.

Indeed there is a strong underlying hint that the private companies engineer in these innovations and quality improvements through altruism and public spirit rather than as a long-term investment which they see generating revenue for another 25 years. In Scotland MPSs were told that in Glasgow:

> "The private sector took the long view that providing new schools would be more cost effective for maintenance than patching up old schoo ls would be. That is an interesting example of a strategic partnership with the private sector that resulted in what I hope is a win-win situation for Glasgow, which has more new schools, and for the private sector which used its innovation to make somethi ng without getting a profit." [37]

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[35] Like bees round a honeypot, *TES* December 19 1997

[36] www.dfee.gov.uk/ppp/contents.htm

[37] John Henderson (Scottish Executive PFU) to Scottish Parliament Education, Culture and Sport Committee, April 24 2001

Mr Henderson appears to have forgotten that the bill for the Glasgow schools project is to be picked up by the taxpayer over the next 29 years.

There is no monopoly of innovation among private sector companies: indeed the same architects would probably be involved whoever was footing the bill for a new school. Innovative design in publicly-funded projects has included the new Peckham Library, Walsall's art gallery, and Notley Green Primary school, funded by Essex County Council. [38]

The "innovations" in school planning have been far from universally popular with teaching and other staff who have to work in the new buildings:

> "As detailed plans are finally released the implications of a commercial mindset are clear – a philosophy that regards staffrooms as "down space"; that seeks to squeeze classroom usage to the maximum ... creating timetable pressures towards larger class sizes; and one that is willing to undermine years of work by physical education departments through the removal of "cost heavy" swimming pools (one of the very few areas of educational provision where Glasgow actually excelled." [39]

Aspects of Highlands School in Enfield, too, failed to impress head teacher Monica Cross:

> "Despite excellent outdoor facilities and a sports hall, there is no gymnasium and staff workspace is insufficient, she says. 'It's got woeful office accommodation. ... There is no examinations office. No secure store.'" [40]

The "Public sector comparator": cooking the books

PFI schemes are required to demonstrate that they represent value for money by comparing the costs of the privately-funded scheme with those of a "Public Sector Comparator" (PSC) (a largely hypothetical exercise, given the lack of public sector capital to enable such a project to get beyond the spreadsheet stage).

However the statistical methods used inevitably skew the odds in favour of the PFI proposal:

- The costs of payments under the PFI scheme are discounted – and by an arbitrary amount of 6% per year – to reflect the notion that money spent now is worth more than the same nominal amount of money spent in five, ten or twenty years time. By this measure £100 in five years has a "net present value" of £74.73, and in 20 years £31.18. This means that the long-running PFI deals have an immediate apparent advantage over public sector schemes in which the investment is assumed to involve immediate borrowing. But this ignores the fact that the revenue costs of PFI (the purchase of supporting services within the finished new schools) do not decline but are index-linked, to rise with inflation over the period of the contract.
- The overall cost of many schools PFI schemes is listed in these deceptive discounted "Net Present Value" (NPV) terms, which show only a fraction of the

[38] *Public Private Partnership: opening up the public private debate*, Janet Sillett, LGIU 2001, p51
[39] Letter to TES from Larry Flanagan, Vice Chair Glasgow EIS, Feb 18 2000
[40] Ifs and buts of a private enterprise, TES November 10 2000

actual cash to be paid to the consortium. As UCL researchers have pointed out, in the case of Haringey,

> "If the schools scheme had used a cash comparison, then the public sector option (PSC) would have been £79m cheaper, on a scheme for which the initial capital expenditure was just £32m." [41]

And in Wiltshire, the UCL report quotes the county's Scrutiny Committee's report, which complains that:

> "the NPV method ... understates the additional costs that will be incurred by the council over the 25 year period. It is not a true reflection of future costs to be incurred due to the unrealistically high discount rate."

- This same process of discounting is also used to calculate the amounts to be paid back to the council under "PFI credits", and is a major factor in the gap betw een the actual cost of the scheme and the amount of support available to pay for it.
- While the costs of PFI deals are artificially reduced through the use of NPV, the costs of the "public sector comparator" tend to be artificially inflated to take account of the "risk" allegedly shouldered by the private sector. (see below)
- Other devices may also be used by advocates of PFI schemes to inflate the apparent cost of the PSC, and make PFI seem better value for money.
    - In Haringey the PSC was inflated by almost £5m on the pretext that a PFI-funded school would improve the educational attainment of pupils and thus enable an extra one percent of them to get jobs, which would, it was claimed, benefit the Exchequer by £4.828 million!!
    - Haringey also added a further £7.4m to the PSC after revising the cost of school services at "prevailing market prices" – which were based not n existing public sector costs, but on higher private sector bids. [42]
- While the private sector bid is able to incorporate potentially cost -saving "innovations" (some of them yet to be tested), the public sector comparator – which will involve minimal creative input, since it is a purely abstract exercise with no likelihood of being put into practice – is required to include no innovations at all. According to Treasury rules, it should be based on

    > "the recent and actual method of providing that defined output (including any reasonable and foreseen efficiencies the public sector could make)" [43]

With the odds stacked against it, and little or no publi c sector cash to bid for, the chances of a Public Sector Comparator coming out cheaper are minimal: but as the Colfox School project showed, some come out very close – that project showed a "saving" of just £400,000 (2%) over the 30 year contract. [44] [45]

<u>Risk transfer</u>

There is also the constant claim by defenders of PFI that the private consortium provides and extra service by taking on "risks" associated with the deal, notably the

[41] *Public Services, Private Finance*, UCL School of Public Policy, for UNISON 2001, p21
[42] *Public Services, Private Finance*, UCL School of Public Policy, for UNISON 2001, p22-3
[43] Public Accounts Committee Twelfth Report: The PFI Contract for the new Dartford and Gravesham Hospital, March 2000
[44] *Private Finance Initiative and Public Private Partnerships: what future for public services?* Centre for Public Services, Sheffield
[45] PFI Fails to deliver big savings, *TES* May 29 1998

"risk" that they fail to complete the buildings on time or that the building s are not fully available when required by the contract.

Again this tends to emphasise the extent to which the public sector has been exploited by private construction firms and contractors in the past.

In practice all of the real risks still remain with the council, but large sums are added to the notional cost of the Public Sector Comparator – in Glasgow a massive £70m – to put a cash value on the transfer of this "risk", even though the City Council was even underwriting the borrowing by the PFI consor tium. [46]

Ministers have been keen to encourage private sector investors to join in PFI deals, underlining that their money is quite safe "in one of the biggest growth markets in the economy". [47]

Researchers Ball, Heafy and King, who investigated Scottish schools PFI schemes have concluded that risk transfer under PFI "may not be as significant as the initiative's proponents claim." [48] They point out that since 1996 successive governments have legislated to reduce the level of risk to PFI consortia. They cit e a school project in which the private sector exerted "continuous pressure" to dilute the penalty clauses that would apply in the event of contract failures. The deal also provides that in the instance of a high-cost construction defect the liability – and "risk" – would fall back on the council.

One glaring anomaly in the supposed transfer of risk is that in the event of a termination of contract after the failure of the provider to deliver the required service, the public sector purchaser will be liable to pay compensation to the failed contractor!

According to the Treasury Taskforce:

> "One question that may be asked is why compensation should be paid to the contractor when it has failed to perform in accordance with the contract. Under a typical service contract, not only would no compensation be paid, but the non - performing party could expect the innocent party to bring claims for damages. The reason that compensation is paid (in PFI contracts) is that a failure to compensate could unfairly benefit the authority i.e. the public sector." [49]

In other words if the PFI contractor was declared in default, the public sector might be seen as gaining the facilities that had been built. In an even more convoluted exercise in accountant-speak it is argued that the public sector "gains" out of this arrangement – because the level of risk attached to FI deals is further reduced, enabling PFI consortia to borrow more cheaply on the money markets.

But whichever way this is spun, clearly the bottom line is that the p ublic sector pays the bills and carries the can in terms of the lion's share of risk.

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[46] *Public Services, Private Finance*, UCL School of Public Policy, for UNISON 2001
[47] Ministers woo private investors, TES July 16 1999
[48] Ball, R., Heafy, M., and King, D. Private Finance Initiative: a good deal for the public purse or a drain on future generations? *Policy and Politics*, January 2001.
[49] Quoted in *Public Private Partnership: opening up the public private debate*, Janet Sillett, LGIU 2001, p21-2

Michael Russell MSP put it another way, asking about the financial argument for the Falkirk schools PFI, under which the council will spend £360m over 25 years to financ e and service a capital investment of £56m in new schools:

> "What is the risk of providing a number of schools that have a guaranteed tenant? There will be a handsome profit. ... The element of risk ... is a risk only if you are not moderately efficient. ... It i s unlikely that the schools will cost in excess of a maximum of £1 million to £2 million in maintenance." [50]

Indeed, as with hospitals and other PFI schemes, the majority of the "risk" which the private sector carries centres on the very first phase – the construction of the new building to the agreed timescale to ensure that the "availability" fees start flowing. Once this phase is complete, the consortium will increasingly return to the money markets to refinance what is seen as a rock-solid scheme at a much lower rate of interest, pocketing windfall profits in the process.

The Norfolk and Norwich Hospital PFI has just been refinanced netting gains of £70m, and the first sizeable school PFI, Colfox in Dorset has already joined the queue for cheaper loans, saving a massive 44% of their borrowing costs. [51]

Refinancing is much more than a windfall profit to the consortium and a rip -off for the public sector: it demonstrates how low is the level of risk within PFI schemes, and how artificially high was the allowance for that risk built in to the original projections, to make PFI seem like value for money.

"Off balance sheet"

One reason the government has urged local authorities (and NHS Trusts) to use private finance is because the loans – floated by the private sector – do not show up as government borrowing, despite the fact that all of the costs of servicing the debt are to be shouldered by the taxpayer.

This is known as keeping finance "off balance sheet". It has continued to be a pressure on public bodies even after the Treasury adopted the official position that accounting reforms meant that this device could no longer be used to conceal the scale of public borrowing.[52]

The London Borough of Merton reflected the widespread view of the significance of PF I in its Outline Business Case (March 2000):

> "It is assumed that securing PRG [i.e. central government] approval for PFI credits will be conditional on the deal being Off Balance Sheet." [53]

This line of policy was even more starkly exposed in Scotland, wher e Minister for Finance Jack McConnell attempted to rubbish alternative suggestions by the SNP n ways of raising public sector capital through bond issues and borrowing at lower rates. He warned that this would in effect jeopardise the status of the borrowi ng:

[50] Scottish Parliament Education, Culture and Sport Committee, April 24 2001.
[51] Update on developments and issues surrounding PFI and PPPs, National Union of Teachers 2001.
[52] *Public Services, Private Finance*, UCL School of Public Policy, for UNISON 2001
[53] Quoted in *Public Services, Private Finance*, UCL School of Public Policy, for UNISON 2001, p10

"The SNP claims that it can borrow at very competitive rates that are significantly below those that are available for PFI schemes. However the only way to reduce the rates is by the Government guaranteeing the loans and, if that happened, the sum would be counted as public sector debt and the programme would be cut." [54]

PFI: the "only game in town"

The real difference between PFI projects and publicly-funded projects is that whatever its longer term costs and problems, with the government steering councils, NHS Trusts and other public bodies down the PFI path, it is increasingly seen as the only chance of getting the cash to proceed and build.

This is closely linked to the spurious notion that PFI is injecting "extra" capital into the public services. In reality every penny of PFI investment has to be paid back from public sector budgets. PFI merely switches the cost of capital investment onto the revenue accounts of public sector purchasers – and spreads the payments of principle and interest over a much longer time-frame.

As a result of PFI, 85% of the funds for major NHS capital projects since 1997 have come via the private sector: but 100% of the costs of this borrowing will be paid by NHS Trusts over the next 25-40 years. As Chief Secretary to the Treasury, Alan Milburn insisted that PFI should become as big in education as it was becoming in the NHS. [55]

According to Gordon Brown's 2001 Budget projections, the total outflow of PFI payments is projected to increase by 56% to a peak of £4.554 billion a year in 2006-7. [56] But this covers only the deals signed already, with many more in the pipeline.

Indeed the cumulative and growing impact of PFI payments on the revenue budgets of health, education and other public services could eventually force the very increases in taxation PFI was intended to avoid. Whatever the pressures n front-line services or on the Exchequer, the profits and index-linked unitary charge payments to the private consortia are guaranteed for a generation.

PFI at the end of the day sells itself to councillors, head teachers and others because with strict limits on the availability of public funding, there is no genuine alternative: it has been deliberately made to seem "the only game in town".

In Lewisham, where the Borough had to seek private capital to upgrade its school kitchens, council leader Jim Mallory pointed out that:

> "Without this deal we would not have the money to make these substantial improvements."[57]

The council's contract manager Mary Mann went even further:

> "The question is not if this is best value. The important thing is we got an investment up-front which we wouldn't have got any other way." [58]

[54] Scottish Parliament Official report June 24 1999
[55] Push for private finance in schools, TES July 16 1999
[56] Budget 2001, Red Book Table C18, from Treasury website.
[57] TES March 13 1998

In Dorset, the assistant county treasurer, discussing the deal for Colfox school, admitted:

> "The reasons we went for a PFI deal were the particular conditions of the school and that we couldn't afford to do it any other way." [59]

In Glasgow, the Labour administration of the City Council pointed out that PPP was the only way they could inject funds quickly into the schools system. Government cash limits meant that

> "The conventional route through borrowing capital in the open market would take until 2014." [60]

A Labour councillor in west London echoed a similar approach, with an even sharper warning:

> "If current government policy remains enthusiastic about controlling public borrowing and limiting capital finance, we have got no choice but to go down the PFI route," says Greg Wilkinson, former associate director of the Audit Commission and now a Labour councillor in west London. "The next question is how do we do this so we don't mortgage the future and don't end up being ripped off by private companies." [61]

In Falkirk, where a flagship scheme for five new schools has been trumpeted by ministers as a triumph for PFI, director of education Dr Graeme Young admits he would not have chosen this solution had there been any alternative:

> "If it were possible for five new schools to have been built by traditional Section 94 with all the employees retained within the council, then that possibly would have been a preferable option. As it wasn't an option, we embraced PFI ...
> "We have been very upfront in pointing out that we could only have funded and financed our PFI programme by dint of this level playing field support."

The same TES article quotes former Labour education convener in Falkirk, Willie Anderson insisting that PPP was "the only game in town". [62]

The Campaign for State Education's Briefing on PFI pojnts out that:

> "Some governors may have many concerns that PFI is not a prudent use of public money ... However they are being told that PFI is Government policy and that "there is no alternative."

Asked "if it could be shown that allowing local authorities to build schools in conventional ways was better value for money, would that be acceptable?" John Henderson from the Scottish executive's Private Finance Unit could only evade the question:

> "I cannot answer your question by asking "Would the funds be made available in sufficient quantities for local government to build its schools traditionally if that

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[58] Doubts over finance initiative, TES March 16 2001
[59] TES May 29 1998
[60] TES June 5 1998.
[61] Deals on funding the future, TES September 4 1998
[62] SNP warns of Falkirk rip-off, TES April 27 2001

> was shown to be better value for money?" All I can say is that ministers would need to consider that very carefully.
> "There is an impression that no money is available to local government to spend on schools unless it takes the PPP route. That is wrong. I think that I am right in saying that the expenditure per annum by local government is more than £100 million, so there are alternatives." [63]

In fact, the Falkirk figures show that the council has a capital allocation which has rise n over 5 years from £7.2m to £8 million a year – to service capital assets totalling over £250 million. Its backlog bill for school repairs was estimated at £40m. Clearly at this level of investment it would be virtually impossible to use government financ e to build five new schools.[64] This is how PFI becomes seen as the only option.

In debate in the Scottish Parliament, the extent of the squeeze on local government capital spending on schools and other services was further underlined by Kenneth Gibson MSP, explaining the complicity of his SNP colleagues in PFI deals, who pointed out that:

> "In 1995-6 government support for local government in Scotland was £734m at constant 1997-8 prices. That support has fallen in the current financial year to £328 million, which represents a cumulative cut of £1,470 million in government capital support for Scottish local government in just four years. That is why Perth and Kinross Council, Angus Council and Moray Council went down the PFI road: they had absolutely no other option."[65]

Conclusion

As with the NHS, the extension of PFI into education rests of tenuous evidence that the private sector has any genuine contribution to make.

The government's case for PFI appears to rest more upon near obsessive secrecy on the detail of the schemes, and manipulated figures designed to show PFI as value for money, rather than any transparent or objective evidence.

Under PFI the public sector is set to foot a mounting annual bill to service over -priced loans, non-existent "risks", and to buy support services whose alleged "efficiency" depends upon worsening the pay and conditions of existing public sector staff. The index-linked profits to the private sector will hang like an albatross around the necks of education authorities and scho ol governors for decades to come.

While Falkirk council will be paying out £360m over 25 years for five schools with a capital value of £56m – but own nothing at the end of the contract, it is clear that a publicly-funded alternative would be better value for taxpayers, school staff and the government.

John Lister, September 10, 2001

[63] Scottish Parliament, Education Culture and Sport Committee April 24 2001
[64] Scottish Parliament Local Government Committee, May 15 2001
[65] Scottish Parliament June 24 1999

Scottish schools PFI projects

Status	Project Name	Procuring Agency	OJEC Main Project	Intention to negotiate (ITN)	Preferred Bidder	Financial close	Capital Value £m	Contract Term
Operational	Falkirk Schools	**Falkirk Council**	Apr-97	Aug-97	Dec-97	Aug-98	**65**	25
b) Signed	Aberdeenshire Schools Project	**Aberdeenshire Council**	Mar-99	Nov-99	Jun-00	Mar-01	**14.25**	25
b) Signed	Mearns Primary and St Ninian's High School	**East Renfrewshire Council**	Jan-98	Apr-98	Jun-99	Apr-00	**12.5**	25
b) Signed	Project 2002 (Glasgow Schools Project)	**Glasgow Council**	Jul-98	Nov-98	Feb-00	Jul-00	**225**	30
b) Signed	Highland Schools Project	**Highland Council**	Nov-99	Jun-00	Sep-00	Jun-01	**17**	25
b) Signed	Balfron School	**Stirling Council**	Apr-98	Dec-98	May-99	Mar-00	**16.5**	25
c) Tenders Invited/Negotiated	East Lothian Schools	**East Lothian Council**	Dec-00	Apr-01	Oct-01	Feb-02	**30**	30
c) Tenders Invited/Negotiated	Fife Schools	**Fife Council**	Sep-99	Oct-99	Aug-00	Jun-01	**32**	25
c) Tenders Invited/Negotiated	Midlothian Schools Project	**Midlothian Council**	Nov-00	May-01	Oct-01	Feb-02	**33**	30
c) Tenders Invited/Negotiated	Edinburgh Schools Project	**The City of Edinburgh Council**	Oct-99	May-00	Jun-01	Aug-01	**80**	25
c) Tenders Invited/Negotiated	West Lothian Schools Project	**West Lothian Council**	Dec-99	May-00	Dec-00	Aug-01	**27.8**	30
e) Potential	Dumfries & Galloway Schools	**Dumfries & Galloway Council**	#NA	#NA	Jun-02	Aug-02	**70**	30
Totals							**623.05**	

Information: Scottish Executive web site. September 2001.

Scottish PFI Deals by Type

	No of Projects	Capital Value £m
Hospitals	26	562.5
Schools	**12**	**623.05**
Colleges	4	42.2
Transport	8	350.1
ICT	11	180.9
Waste Water	10	654
Waste Management	6	144.7
Waste to Energy	1	43
Other	10	103.1
Total	**88**	**2703.55**

PFI schemes for schools signed in England up to July 2001 that are receiving PFI credits

LEA	Project	Value £m	Date signed	Consortium	Other details
Birmingham	Refurbish 10 primary and secondary schools	50.6	Feb-00	Galliford	PFI credits: £42.6m Project payments (NPV) £271.8m (30 years)
Brent	Relocate Jews Free School	9	Jan-01	Jarvis	
Cornwall	Repair and rationalise 4 secondary schools and linked primaries	50.7		NewSchools	Initial capital outlay of £33m. Deal worth £148m
Derbyshire	Two secondary schools	29	Mar-01	Babcock & Brown	Deal worth £40m
Dorset	Colfox secondary	15.6	Nov-97	Jarvis	First costed at £9.5m when proposed under Tory govt. Opened Sept 1999. Capital value £13m. Project payments (NPV) £22.4m. PFI credits £15m. Contract cost £240,000 in consultant feees and £250,000 in Council Officer time. Deal is claimed to "save" £400,000 over 30 years! Running costs will consume 12% of school's budget.
Dudley	IT services for 100+ schools	29.5	Jan-99	Research machines/ BT	Operational 1999. Project payments (NPV) £49m (10 years). PFI credits £25.6m Additional credit £2.4m
East Riding	Six schools in Bridlington	26	Dec-00	Jarvis	
East Sussex	5 schools in Peacehaven	19	Mar-00	Peacehaven Schools Ltd	First primary open Jan 2001. Project payments (NPV) £30m (25 years). PFO credits £18m.
Enfield	Highlands School	15.9	Mar-99	Laing Hyder	Opened Sept 2000. 25 year deal will cost £60m
Essex	Debden Park School	11.1	Mar-00	Jarvis	
Haringey	Grouped scheme, 1 new & refurbish 8 secondary schools	62.5	Oct-00	Jarvis	Capital value £40m (? 4Ps) Project payments (NPV) £95m (25 years). But Jarvis will actulally be paid £230m. £54m will be invested in first 3 years.
Hillingdon	Barnhill secondary school	18.8	Nov-98	Jarvis	Capital value £16.8m. Project payments (NPV) £25m (25 years). PFI credits (?) £18m (4Ps)
Kent	Primary and part of secondary school	11.6	Mar-01	NewSchools	Contract wprth £30m over 25 years
Kingston upon Hull	Victoria Dock Primary	2.8	Jul-98	Sewell Group	First PFI school completed. Opened Jan 99; doubled in size Jan 2001, Capital value £2m. Project payments (NPV) £2.8m (25 years), but cash payable adds up to £5m.
Kirklees	20 school refurbishment	59.2	May-01	Jarvis	30 year deal, contract value £313m (Jarvis)
Lancashire	Fleetwood High	13.4	Mar-01	Eric Wright Group	
Leeds	Cardinal Heenan School	4.1	Jun-99	Jarvis	Opened Sept 2000
Lewisham	Catering services from 66 school kitchens	4.3	Feb-99	Compass	10-year contract includes kitchen refurbishment: PFI or privatisation??
Liverpool	Lifelong leaning Centre	10.8	Mar-01	Education Solutions	Capital value (4Ps) £26.3m, PFI credits £20.4m, Project payments (NPV) £34.787m. Affordability problems meant costs had to be cut. Contract had to be passed by four sets of lawyers!
Manchester	Temple School	3.7	Mar-00	NUPPP	(Norwich Union)
Newham	2 primary 1 secondary	30	Mar-01	NUPPP	Capital value £23.8m. PFI credits £30m. Project payments (NPV) £44m (25 years)
North Yorkshire	4 schools	7.2	Mar-00	Accord plc	
Portsmouth	New secondary school	12.4	Mar-99	Grannag	Open Sept 2000
Sheffield	Rebuild 2 secondaries and 2 primaries	58.8	Mar-00	Tilbury Douglas	First primary now open. Life value of contract £250m (Tilbury Douglas - now Interserve) over 25 years.
Staffordshire	Cooper Perry School	13.7	Mar-00	Norwest Holst	

Stoke on Trent	Build 9 new schools in 5 years, repair and maintain all 122 schools	93	Oct-00	Transform Schools	Total cost £153m over 25 years. Consortium involves Balfour Beatty, best known for Railtrack contract and signalling failures in Hatfield crash
Torbay	Rebuild 2 schools	14.2	Mar-00	Jarvis	
Tower Hamlets	Rebuild school	8	Mar-01	Accord plc	
Waltham Forest	Lamas Community School	18.5	Sep-01	WS Atkins	Capital value £14m. PFI credits £18.5m. Project payments (NPV) £28.9m (26.5 years)
Wiltshire	3 schools	38.6	Oct-00	White Horse Education Partnership	Deal worth £125m over 30 years. Council faces shortfall of £400,000 a year on funding for deal. Malmesbury School will wind up paying 10% of its budget to contractors for support services.
Wirral	9 schools	55.2	Mar-01	Jarvis	PFI credits £55.2m, additional credit £3.3m, Project payments (NPV) £79.8m (25 years)
30 school schemes	**Total value**	**797.2**		Total value	
Schemes in process					
Brent	Upgrade and maintain 32 schools	23			25 year deal
Crawley	Build 3 new schools and refurbish	60		Procurement due to compkete 2003	
Liverpool	Build 15 new schools, refurbish 3	74	Pending	Jarvis	Total project cost £252m
Newcastle	Upgrade six schools	33			
Redbridge	New secondary school	17	Delayed	NUPPP	Contract delayed because of dispute over the size of the bill.
Scotland					
Glasgow	Build and refurbish entire school stock of 29 secondary schools	£220		3ED	First costed at £40m to refurbish 26 schools (1997). now 12 new schools are to be built. Estimated cost rose to £70m, then to £136m by 1998. Glasgow City Council will rent schools for an annual fee of £40.5m in a 29-year deal worth £1.2 billion. Deal subsidised by £17m a year from Scottish Parliament. Estimated to be £35m more expensive than public funded option. 600 support staff to be transferred to private employers.
Edinburgh		70			City council claims deal would save 11.5%, despite higher cost of borrowing for private sector.
Falkirk	5 new schools	68	Aug-98	Class 98 Ltd	25 year deal. £83.7m was borrowed, the remaining £15.7m being used to "cover capitalised interest, financing costs, working capital and a contingency amount". Total cost £340m Council refuses to open up books to scrutiny.
Renfrewshire	St Andrews School	45			Original plan was for extension costing £3.75m. Scottish Executive proposed new school. Council estimates building cost at just £19m.
Stirling	Balfron High	15			
	Scottish totals	£418			