



## A critical financial analysis of the Private Finance Initiative: selecting a financing method or allocating economic wealth?

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### Abstract

The UK government's Private Finance Initiative (PFI) policy raises a series of questions about the rationality and distributive implications of using private finance, inevitably more expensive than public finance, in essential public services. This paper, by examining the process, the financial methodology, its assumptions and the data used in the system of appraisal for new hospital builds under PFI, shows that the decisions rested upon the ambiguous concepts of risk transfer and value for money at the level of the individual hospital rather than the system or society as a whole. These concepts were far from neutral and provided the rationalising motif for a process that transfers resources from the public at large to the financial elite, thereby obscuring the distribution issues that were largely missing from the policy debate.

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The British government has used the Private Finance Initiative (PFI) to finance the modernisation of Britain's ageing public and social infrastructure, including roads, prisons, hospitals and schools. Introduced by the Conservative government in 1992, the incoming Labour government revitalised the PFI and rebranded it as Public Private Partnerships, an umbrella term that includes PFI, in 1997. While privatisation was the preferred policy measure for reform of the state owned trading enterprises, partnerships are playing a key role in the transformation of the largely non-traded public services that could not be privatised for political or financial reasons.

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Partnerships have taken different forms in each of the public services. While they differ in their mode of operation, they nevertheless share certain common features. Services remain publicly funded and subject to a regulatory framework set by government, and the core professional or front line services as in health and education are provided by the public agency: this is the ‘public’ aspect. The ancillary services are provided by the private sector, as is the physical infrastructure to support both the professional and ancillary services: this is the ‘private’ and ‘finance’ aspect of the partnership arrangement. Like the privatisation programme that preceded it, it is a policy that is now being emulated around the world. The purpose of this paper, a critical financial appraisal of the policy, has therefore international relevance.

As with many public policies, the rationale has changed over time. The government now emphasises that PFI will deliver greater value for money (VFM) over the life of the projects because the private sector assumes some of the financial risks (and costs) that the public sector would otherwise carry (Treasury Taskforce, 1997a, 1997b). Indeed, value for money is the main justification for choosing public or private finance for delivering public services. Its central element is the standard investment appraisal technique based on the comparison of the discounted cash flows of different options, including privately financed options, and the selection of the one that offers the greatest financial benefits, although affordability and public service obligations should also be considered. PFI proposals have to prove their *expected* value for money to the public agency to gain approval to proceed. The emphasis on appraisal and ‘value for money’ is part of a wider government initiative to introduce formal techniques into the UK public sector decision-making process to allocate resources on a more rational basis, free from political interference or managerial preference, which in turn is assumed to lead to a more socially efficient allocation of resources (Treasury, 1997a).

But the theory and practice of investment appraisal is not unproblematic, particularly in the context of public services, as others have noted (King, 1975; Ross, 1995; Tribe, 1972). The complexities of PFI add further difficulties (Froud and Shaoul, 2001). In addition, the use of such techniques at the unit level, particularly in the context of services such as health, whose complexity requires planning if comprehensive, universal and equitable coverage, key goals of the National Health Service (NHS), are to be achieved, does not necessarily ensure sound decision making at a wider level, either locally or nationally. But as others have pointed out, it is not just that such techniques can be problematic or misused, they are also value laden: “the myth endures that techniques *in themselves* lack substantive content” (Tribe, 1972, p. 75). In the context of investment decisions between public and private finance, what is at stake is not just the selection of particular projects, but also the allocation of resources between the public and private sectors of the economy (Brown and Jackson, 1990), and the important distributional consequences that flow from that choice. This paper therefore explores the distributional implications of the methodology and practice of appraisal put in place by the government using *ex ante* evidence from the first wave of acute hospitals to be built under the PFI.

Public discussion and academic research, following the agenda set by the British government, has largely taken an ‘evaluative’ approach whereby proposals are judged at the narrow project level in terms of their value for money. There have been a number of empirical studies examining the *ex ante* value for money in specific hospital projects (Gaffney and Pollock, 1999a; Pollock et al., 2000; Price et al., 1999a, 1999b), in the health service (Gaffney and

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