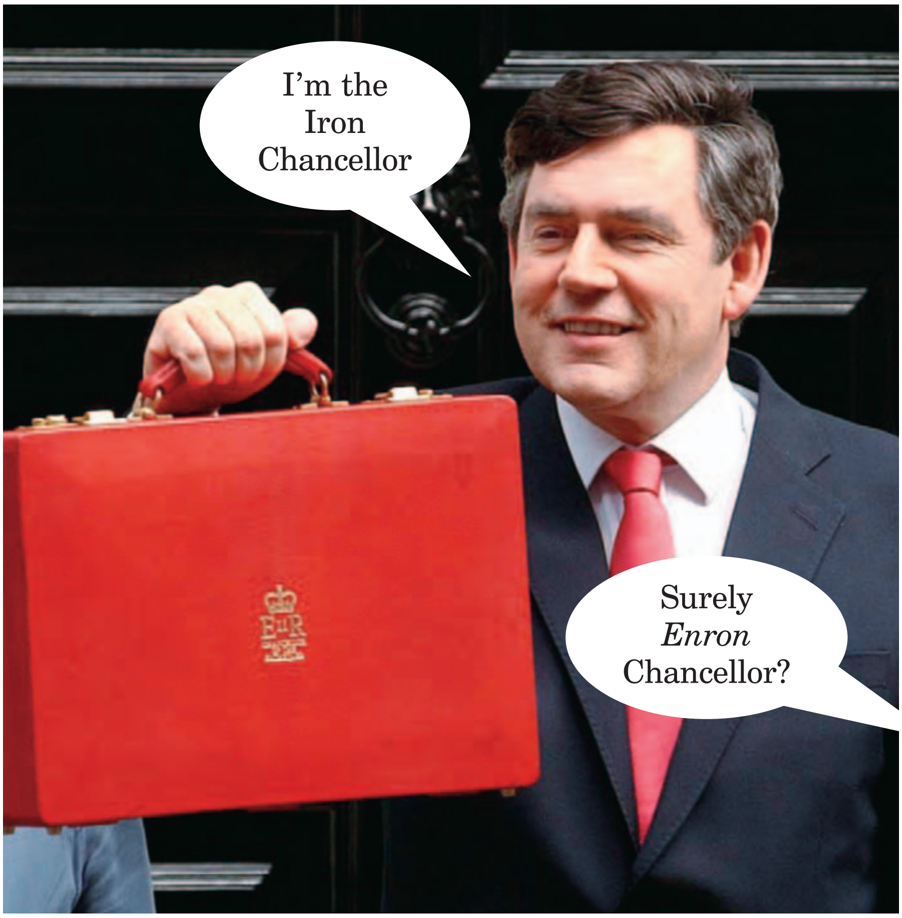
P.F.EYE

An idiot's guide to the Private Finance Initiative

A Special Report by Paul Foot

This is the story of the Private Finance Initiative: how it became a jewel in the crown of New Labour, its savings, its costs, its pitfalls and windfalls, and how it changed the face of British accountancy and British politics…



WIND IN THE WILLETTS

NORMAN LAMONT tinkered with it. John Major approved it. But the intellectual thrust for the idea of the private finance initiative (PFI) came from David Willetts, the Tory frontbencher nicknamed "Two Brains". In a pamphlet in 1993 called *The Opportunities for Private Funding in the NHS*, published by the Social Market Foundation and financed by the private health insurance company BUPA, Two Brains came up with a brainy idea. Instead of paying for hospitals by public funding, why not get reliable old private enterprise to build and run them — and then, at the end of the process, inherit them too?

When he wrote the pamphlet, Willetts was a consultant to Healthcall, a private health firm. (In 1997, when the Tories lost office, he became an adviser to the Dresdner Kleinwort merchant bank, which rapidly became one of the great beneficiaries of PFI.) But back in the early 1990s, two brains were rather too many for Tory leaders of the day and the idea of PFI wasn't very popular in the treasury either. Senior civil servants liked to keep tight control on NHS spending and old-fashioned mandarins there felt the radical ideas of Two Brains might be going too far.

When Kenneth Clarke succeeded Lamont as chancellor, he endorsed PFI and wrote it more firmly into the government's programmes. But he insisted that PFI would only work if the whole of the financial risk of a project was transferred from the public sector to the private sector. This caused a lot of concern to private contractors and banks. Their directors were prepared to bid for government contracts for which the government was eventually responsible, but were not at all happy about bidding for contracts for which private contractors might be held liable.

Another worry was the Labour opposition whose MPs were inclined to oppose such measures as "creeping privatisation". So although Two Brains' theory was officially adopted by the Tory government, it never really got off the ground. As predicted by the sceptics, the idea infuriated Labour and the trade unions. In 1996 the TUC vigorously opposed PFI and in a Commons debate on 1 May the same year, Labour frontbencher Sam Galbraith got to the root of the matter.

"The private finance initiative," he concluded, "is basically all about government bodies borrowing money but not having it set against the public sector borrowing requirement." He forecast: "Today, the private sector will only get involved in the PFI within the health services if it carries no real risk." The result, he said, was "a financial sleight of hand, a massaging of figures as a result of which the increase in the public sector borrowing requirement is not shown and is thus a matter of deceit."

In another debate another Labour frontbencher, Harriet Harman, denounced the concept of PFI in the NHS in terms that won warm support from her colleagues. "When the private sector is building, owning, managing and running a hospital," she declared, "that hospital has been privatised." Yet unknown to Harman, the leaders of her party were engaging in secret discussions to make sure that if and when they came to office, the private sector would do precisely that: build, own, manage and run new hospitals.

David Willetts MP

ENTER MONSIEUR BOURGEOIS

The politician in charge of this dramatic conversion was Geoffrey Robinson (right), a Coventry Labour MP whose impact on his party's policies had until then been marginal. Robinson's chief claim on his party's policy makers after Tony Blair became party leader in 1994 was his enormous wealth. Blair and Gordon Brown were both dazzled by it. They made full use of Robinson's agreeable holiday villa in Tuscany, not to mention his luxury flat on the French Riviera.

Both men believed that great wealth of the kind available to Robinson was a sign of great enterprise rather than a chance inheritance Robinson had been bequeathed by a Belgian businesswoman called, deliciously, Madame Bourgeois. Blair and Brown recruited Monsieur Bourgeois Robinson to sound out friendly tycoons and woo them to New Labour.

Among the first City firms approached by Robinson was the British branch of the big American accountants, Arthur Andersen. Andersen's sister company, Andersen Consulting, had already demonstrated a deep and selfless interest in the Labour party. It had not charged a penny for the help it had given Labour's Commission for Social Justice in devising a suitable policy on tax and welfare benefits; and on the day Labour leader John Smith died in May 1994, it recruited a bright young Labour politician called Patricia Hewitt who had worked on the commission and had been press officer to Labour leader Neil Kinnock.

Hewitt left Andersens in 1996 to devote her attention to winning the safe Labour seat of Leicester West where she was the prospective Labour candidate. In that same summer, Andersen Consulting arranged a conference in Oxford for Labour frontbenchers in which the party's budding ministers were lectured by City experts on how to behave responsibly.

One issue that fascinated Andersens was the private finance initiative. Its experts investigated the mystery of why PFI had failed so bleakly under the Tories when not a single hospital PFI scheme had been signed. The main reason, they quickly concluded, was that the initiative put the private sector at too great a risk. An even greater worry was the legal implication for the companies engaging in PFI deals. It was not at all clear, for instance, whether the NHS trusts which ran the hospitals, or local councils were allowed in law to enter into their own contracts with big business. In discussions with other City accountants and consultants (and with Geoffrey Robinson), Andersens sought ways to change the rules and laws to make PFI more amenable to private corporations. They were greatly assisted in these discussions by a prominent member of the Tories' private finance panel, a former GEC director called Malcolm Bates.

As soon as Labour was elected in the spring of 1997, the new prime minister Tony Blair and his chancellor Gordon Brown took their Tuscany host Geoffrey Robinson into the government as paymaster-general. In his book *Unconventional Minister*, published in 2000, Robinson boasts of the breathtaking speed with which he and his former City cronies paved the way for PFI.

In the week after the election he set the former Tory favourite Malcolm Bates to work on the subject. Bates wrote a report in six weeks and by the end of June 1997, barely two months after the election, all its 30 recommendations had been accepted. They were implemented by November. As Robinson had drooled in a treasury press release on 23 June 1997, demonstrating his masterly control of cliché: "We do not let the grass grow under our feet here."

Ross Goobey, the chairman of the Tories' PFI panel who had had doubts about PFI, was sacked, with the entire Tory panel. It was replaced by a leaner and more select "task force" in the treasury headed by a merchant banker from Dresdner Kleinworts called Adrian Montague. Montague's "infinite patience", wrote Robinson, had been "acquired as chief legal counsel in the negotiations on the Channel Tunnel". By the time Robinson wrote his book in 2000 (following his sacking in 1998 for lending half a million quid to government colleague Peter Mandelson), he should have known that the Channel Tunnel and its private enterprise controllers had been responsible for one of the most appalling commercial disasters in British history. But he was too tactful to mention it (or the key role Montague had played in the almost equally calamitous privatisation of the railways).

Another vital ally in those early discussions chaired by Robinson was Steve Robson, a senior civil servant who had also been closely involved in railway privatisation. Robson's almost religious enthusiasm for privatisation in every form swung him behind PFI, and his limpet-like association with paymaster-general Robinson helped him transform the treasury from a department known previously for its prudence when dealing with private contractors and entrepreneurs into a generous provider of public funds to such people.

In his less than flattering book about Robinson, the author Tom Bower explains why the Robinson proposals so delighted the beneficiaries. "The popularity of Robinson's proposed changes for the PFI contracts among the majority of bidders and merchant bankers was unsurprising. The private sector under Robinson's regime would be allowed to earn profits without bearing any risks. The new terms of PFI contracts approved by Robinson lacked clauses allowing the government to recoup windfall profits earned by the contractors and anticipated that the public would pay more for hospitals and schools than if the funds were wholly provided by the state… By offering overtly more generous terms to contractors than his predecessors, he could boast that projects worth £14bn would be signed by the end of 1999."

The popularity of the new measures among the contractors is one reason the startlingly prompt action by the government on PFI was so little noticed in the public prints. The formation in September 1997 of an entirely new task force dealing specifically with PFI, and a treasury press release in which Adrian Montague modestly described it as a "really strong team of young Turks", got almost no publicity. All the young Turks were lawyers, bankers or business consultants. No trade unionist, Labour MP or Labour lord was even interviewed.

HILARY'S SAFE HARBOUR

Two immediate problems confronted Montague's young Turks. The first was that under existing laws, many of them passed by previous Labour governments, hospital trusts might not have been able to enter into legal contracts with private businesses. The second was that local councils might be similarly restricted. Hence new laws were called for to boost the confidence of the contractors.

The first was entrusted to Hilary Armstrong, the minister of state at the new department of the environment, transport and the regions. She spoke up for the banks, which, she said, "fear that partnership contracts with local authorities may be found unlawful". The consequences of such potential illegality were, she said, quite frightful: "The banks would then suffer financial losses" and the private sector would be "saddled with bad debts." This was an appalling vista, she insisted, that the government must "act quickly to dispel".

The new local government contracts bill, she said in the debate on its second reading on 23 June, provided the private sector with a "safe harbour". From the Tory frontbench the seasoned Tory privatiser Christopher Chope could not contain his delight. "I understand," he said, "that we probably would have introduced a bill in not dissimilar terms."

The following month, on 14 July, another new minister, this time in the department of health, Alan Milburn, an almost maniacal convert to PFI, moved the second reading of another bill "to unlock the PFI gridlock in the National Health Service." This was the National Health Service (private finance) bill that made it unquestionably legal for health trusts to negotiate contracts with private businesses "so that the financial community can have the confidence that it needs to provide funding for the most advanced hospital development projects".

From the Tory frontbench John Maples MP made it clear where the bill had come from. "It is not our intention to oppose the bill," he said. "It is our bill." Thus without a word of protest or even doubt from the massed ranks of newly-elected Labour MPs, PFI soared into orbit and millions upon millions of pounds flowed out of the banks to pay for a new set of PFI hospitals.

Most Labour ministers looked on this flow of money as if it were a miraculous display of new investment by a private industry transfixed with wonder at the new Labour administration. They did not seem to appreciate that the "new investment" carried with it a heavy burden of "new debt" that would cripple the promised hospitals at once and had to be paid back over at least a quarter of a century.

By the time Geoffrey Robinson and his personal debtor Peter Mandelson were booted out of office at the end of 1998, all this discussion and legislation had attracted very little public debate. Isolated journalists — Roy Hattersley in the *Guardian*, Arnold Kemp in the *Herald* in Scotland, Will Hutton and David Leigh in the *Observer*, for instance — began to wonder about the consequences for the government if the PFI contracts continued at even half the same rate. But for the most part there was silence.

The contractors and their supporters in the Tory party were delighted at the PFI windfall. Indeed, some Tory MPs' firms were part of the lucky consortia that won the PFI contracts. But most Labour MPs who might otherwise have been critical were so impressed by the sudden construction of new hospitals in their constituencies that they merrily swallowed the government's arguments that the new hospitals would never have been built had it not been for Robinson's new magic cordial, the PFI.

By the summer of 1999, however, critics of PFI were in full voice. To start with they concentrated on the impact of the new policy on the National Health Service. In July 1999, the *British Medical Journal* published a stinging leading article entitled *PFI — Perfidious Financial Idiocy*. The article was based on research carried out by the School of Public Policy at University College London (UCL) and its professor of health policy research, Allyson Pollock, a former national health service clinician.

In *BMJ* papers going back even before the 1997 election, Professor Pollock and her team had established themselves as consistent and reliable critics of PFI and, as their criticism grew, they earned for themselves a considerable reputation in the NHS as well as the furious invective of New Labour and its growing band of dedicated consultants and policy advisers.

In 1998 and 1999 she and her colleagues published more powerful papers warning of the consequences of PFI for the NHS. The latter of these papers, entitled *Pump-Priming The PFI*, published in *The Public Money and Management Journal* (Jan-March 1999), examined 35 major schemes for new hospitals, almost all of them to be built by PFI. They found that the government's assumption that "efficiencies on the part of the PFI contractors would offset the higher costs of capital" were "increasingly unconvincing".

In a devastating table (see page seven), put together from official figures all over the country, the authors published the "outline business case costs" and the "current costs (1999-2000)" — even before the contracts were signed off — of the first 15 PFI hospital projects. Some of the increases were hideous. At Swindon, the increase was 229 percent; at Worcester 137; at South Manchester 123; Norfolk 122; and Bishop Auckland 100. Far from the private sector cutting the costs, the capital costs had actually *increased*.

Who was to pay for these increases? Some of them could be met by land sales. But clearly the extra costs of borrowing caused by the increase in the costs since the outline business case for PFI was originally presented, had to come from somewhere else. But where? The papers identified four sources: health authority budgets at the expense of other services, including primary care mental health; capital budgets intended for the rest of the NHS; special subsidies from the treasury that came to be known as "smoothing mechanisms"; and finally from the revenue of the hospital trusts themselves, which led inevitably to cuts in hospital beds and reductions in nursing staff.

Alan Milburn greeted PFI in the NHS with open arms

The *Eye*'s first reference to the new initiative was in June 1997, when the magazine's medical correspondent M.D. printed a letter written in March 1997, a few weeks before the election, by Labour's then frontbench spokesman on health matters, Chris Smith. His letter — to a Ms Carlo — raised the controversial Tory PFI proposals for a new hospital for Norfolk and Norwich. Smith outlined his party's "serious concerns about the operation of the Tory PFI" and assured Ms Carlo that before making any final decision, the Labour government would "rapidly undertake a listening exercise with local people".

M.D. went on to point out that plans for the new hospital were going ahead full speed under the new Labour government (Smith was no longer dealing with health: he had been transferred to culture) "without a whiff of the promised public listening exercise". As M.D. observed:

- The new PFI hospital was sited outside Norwich city boundaries, meaning considerable extra travel for patients.

- The new hospital would have fewer beds than the one it replaced.

- The PFI was exceedingly unpopular. At a meeting in Norwich attended by more than 200 and addressed by the local health trust chief executive, just six people voted in favour of the PFI proposal.

M.D.'s observation — "to most it seems that political diktat is triumphing over commonsense" — was prescient; and the themes of the article became increasingly familiar to *Eye* readers in the months that followed.

Labour's astonishing U-turn in its attitude to PFI was exposed in March 1998. Before the 1997 general election, Labour had distributed "Save the NHS" leaflets in Inverness, attacking Tory plans to build a new PFI hospital for the elderly in Stonehaven. At the time Dundee Labour MP John McAllion had described the idea as "a complete betrayal of the founding principles of the NHS". Nevertheless, the complete betrayal continued under Labour and the hospital in Stonehaven, financed by PFI, duly opened.

In July 1998, *Eye* 955 attributed the Stonehaven contract to the ardent support for PFI among civil servants in the Scottish Office. Keenest of these was the former assistant secretary in charge of development, Bill Moyes, who had been "seconded" from the civil service to the British Linen Bank, a subsidiary of the Bank of Scotland. In November 1996 he became a full-time executive director of the British Linen Bank. In January 1997, when the successful consortium bidding for the Stonehaven hospital contract was named, it included… the British Linen Bank.

Moyes never forgot his early triumph as a health service privatiser and banker. After a rather dull stint at the British Retail Consortium, he was recently appointed regulator for the government's much-coveted "foundation" hospitals, which will be floated off as business corporations.

Potential conflicts of interest in the new PFIs absorbed the *Eye* in those early New Labour years. In July 1998, under the heading *Master Bates*, the *Eye* discussed the crucial role in PFI policy-making, first under the Tories and then under New Labour, of Malcolm Bates. One of his most remarkable achievements was the commissioning of a brand new hospital (like the one at Norwich, some way from the city centre) to replace the old and much-loved Edinburgh Royal Infirmary. The old site (and four others almost as valuable in the city) were snapped up and sold by the lucky consortium that had the PFI contract. The consortium was headed by the big cable and construction firm, BICC. "Soon after the project was launched," *Eye* 954 reported, "a new director joined the board of BICC — Malcolm Bates."

Bates was knighted in the Queen's birthday honours in summer 1998. The *Eye* returned to the subject of the PFI king three months later under the heading *Master Bates Comes Again*. The headline referred to the extraordinary fact that Sir Malcolm had now been appointed chairman of London Transport, in which post he would be supervising many of the PFI contracts he himself had inspired.

Wondering whether he would be negotiating with himself as director of BICC, whose subsidiary Balfour Beatty was involved in the London underground PFI, the *Eye* put the question to BICC. It initially confirmed that Bates was a director. More

Hilary Armstrong worried that banks might 'suffer financial losses'

The *P*erfectly *F*ormed *I*ndividuals behind PFI

Robson greed

STEVE ROBSON (left), in charge of privatisation at the treasury in the early days, is often referred to as the government's privatisation "guru". When Labour's paymaster-general Geoffrey Robinson gave the private finance initiative such a boost in 1997, Robson took control of strategy.

In 2000 he was knighted and a year later Sir Steve retired from the treasury. Since then he has become a non-executive director of Cazenove, Royal Bank of Scotland, the mining firm XStrata and Partnerships UK (PUK). At PUK he is officially the "treasury nominee" although his bank, RBS, is one of the biggest beneficiaries of PFI.

Robson is outspoken in support of PFIs and privatisation and, despite his long stint at the treasury, is a harsh critic of the public sector. In many interviews he has said privatisation of the railways was "absolutely right". He has addressed a "power lunch" at the right-wing Adam Smith Institute on "modernising" (ie privatising) health and education. And in a *Guardian* article in 2001 he wrote that the public sector was "averse to improvement". For good measure he told the Commons public administration committee that the idea of a "public service ethos" was "fantasy".

In April 2003 Robson led the right-wing Reform Commission on reform of public services. His colleague was New Zealander Roger Douglas, the man behind the ultra-free market "Rogernomics" that produced record unemployment and poverty in New Zealand in the 1980s. Among their conclusions was that increased healthcare costs should not be funded by the taxpayer.

Adrian's toll

WHEN a hugely influential transport conference took place in Rome last autumn, the hugely influential businessman appointed to drum up support for it was one Adrian Montague (above), the government's leading expert on PFI and PPP.

Among the subjects mysteriously *not* discussed at the conference were:

- The not very successful privatisation of Britain's railways and the energetic role played in that by an ambitious City solicitor at Linklater & Paines, called A. Montague.
- The not very successful treasury task force and the key role in it of a former City solicitor and banker from Dresdner Kleinwort called A. Montague.
- The not very successful privatised successor to the treasury task force, Partnerships UK, aka PUK, and the role of its deputy chairman, one A. Montague.
- The significance of gongs in industry – in particular the CBE awarded in 2001 to A. Montague.
- The role of private finance advisers to the New Labour government – and the appointment in 2001 of one A. Montague to give private finance advice to the deputy prime minister and then transport overlord, John Prescott.
- The stupendous losses at British Energy and its plight under its chairman, er, A. Montague.

The Marconi Gang

EVEN before they took office, New Labour ministers were always hunting for top businessmen to worship. They were dazzled by the size and reputation of firms such as GEC/Marconi, one of the biggest manufacturing companies in the country, built up under the legendary genius of Lord (Arnold) Weinstock.

Almost anyone with any record in GEC/Marconi could be sure of a warm welcome in Downing Street and the ministries. Almost the first businessman to be made a lord by Tony Blair was Lord (George) Simpson, chief executive of Marconi, whom Blair begged to come more closely into government, only to be told by Simpson that he was putting all his efforts into GEC/Marconi.

Marconi-worship partly explains the enthusiasm for Sir Malcolm Bates (right), a former GEC director, as the man best suited to launch new Labour's PFI; and the promotion (from industry) of former Marconi managing director Sir Peter Gershon (below) as head of the Office of Government Commerce, the leading government agency on PFI.

While all these men were ennobled, knighted and promoted, what happened to GEC/Marconi itself? It got hopelessly caught up in the great telecoms bubble of the late 1990s and burst with it. It posted losses of £5bn and sacked 6,000 people in Britain alone, and was only saved from bankruptcy by panic restructuring.

Eye questions to the relevant government department then revealed that Sir Malcolm had resigned as a director on the very day the *Eye* had asked about his role.

THE DARTFORD FUNNEL

Through 1998, 1999 and 2000, the *Eye*'s attention shifted from potential conflicts of interest to the central arguments about PFI itself. As more and more hospitals were built under PFI, more and more questions were asked about them in the *Eye*. For example, were the new hospitals cheaper than a public sector alternative and were they really affordable?

The PFI system for new hospitals is similar to that of a mortgage. The NHS selects a consortium of construction companies, banks and accountants, which builds the hospital and runs it for a long period, usually 25 to 30 years. In exchange, the government pays an agreed sum every year to the consortium. The payment covers "servicing", (portering, catering, cleaning, laundry and something called the "life-cycle cost") — and the debt of the initial purchase price.

As with a mortgage, the eventual sum paid by the taxpayer to the consortium is enormously larger than the amount initially borrowed. But the increase in the costs of the hospitals since the outline case was first presented meant that the taxpayer was in an even worse position with PFI than the ordinary householder who takes out a mortgage. The government was committing taxpayers to hugely higher payments than would have applied under a publicly-owned and publicly-funded system, and for greatly reduced services.

Indeed, it was rather like taking out a mortgage on a credit card. For the new hospital at Dartford, Kent, the cost of servicing capital rose from 6.7 percent under the old system of public procurement to a fantastic 32.7 percent of income under PFI. The result? Heavy cuts in health services, notably to people with learning difficulties and the district nursing system.

Similar figures applied to all the new PFI hospitals. But the issue which emerged so clearly from Professor Allyson Pollock's work in 1999, and continued to dog the government, was the condition of the new hospitals: notably the fact that in every case they provided for fewer beds, staff and services for fewer patients than did the hospitals they replaced.

Frank Dobson, New Labour's first health secretary, opened the new hospital at South Tees with a flourish, denouncing the opponents of PFI as follows: "Who do critics think have been building hospitals before PFI?" he asked. "Charities or volunteers? Of course not. They were built by the same profit-making private companies now involved in PFI." *Eye* 986 answered as follows: "This interesting new argument suggests Dobson cannot see the difference between hiring a plumber to put in your new bathroom and letting the plumber take over your whole house on condition he rents it back to you for the next 30 years — and paying him extra to do your cooking and cleaning." To help the health secretary, the *Eye* provided three conveniently ignored facts about the South Tees hospital and PFI:

- The new hospital was being built by Mowlem and Carillion. The latter was strongly criticised by the independent think tank Labour Research as one of the firms most commonly using "union busting" to get round the government's fairness-at-work proposals.
- Carillion, then Tarmac, was prime contractor on the first PFI hospital, Dartford and Gravesham. The national audit office (NAO) said the scheme was certainly no cheaper and possibly more expensive than a traditional rebuild.
- The old South Tees hospital had 1,051 beds for patients. The new PFI hospital had 980.

There were even more drastic cuts in beds at the new PFI hospitals in Carlisle, Bishop Auckland and Halifax. Prof Pollock and colleagues found that in all the new PFI hospitals there were 30 percent fewer beds than in the ones they replaced. Nor was this a coincidence or accident. There was much evidence that the PFI hospitals were specifically designed to cut the length of stay in the hospitals, increase occupancy and so improve the "throughput" and economic "return" — or profit as it used to be known in the olden days.

CHANGING THE LOCK

The issue came to a head in Worcestershire, where a new PFI hospital was to be built to replace the Worcester Royal Infirmary. How to pay for it? The local health authority launched an urgent strategic review to find the money. The chief proposal was to demote the smaller hospital at Kidderminster to a mere shadow of its former status. Acute operations and beds were to be removed and the revenue from them shifted to the new PFI hospital at Worcester, 17 miles away.

The PFI proposal was initially opposed by the Labour candidate for the local constituency, Wyre Forest: a Birmingham barrister called David Lock. To his and everyone else's astonishment, Lock was elected to parliament in the 1997 general election and continued to campaign against the emasculation of Kidderminster hospital. His attitude changed, however, as he climbed swiftly up the political ladder, becoming a parliamentary private secretary in October 1997 and a junior minister in the lord chancellor's department in 1998.

As a government minister, he could hardly be seen to be opposing his own government's PFI proposals in the health service, so he defended the hospital plans he had previously attacked. His shift in attitude infuriated the local population. As M.D. had spotted in Norwich in the summer of 1997, PFI for NHS hospitals was exceedingly unpopular. The people of Wyre Forest decided to challenge the decisions of their health authority and MP with their votes.

What happened as a result was set out in *Eye* 1005 in June 2000. As soon as the government's support for the new PFI proposals were announced in March 1999, the campaign to save the hospital was transformed into a new political party called Health Concern. Its aim was simple: to keep Kidderminster hospital intact. Its chairman was Richard Taylor, a retired hospital consultant.

There were only a few weeks to go before the council elections of 1999, but several candidates were scrambled together, and in Wyre Forest council, which includes Kidderminster, seven were elected. Four others were elected in districts in Shropshire which came within the hospital's catchment area. In the following year, 2000, eight more Health Concern candidates were elected. As the *Eye* noted: "There are 19 Health Concern councillors in Wyre Forest — by far the largest party — 11 Labour, five Tory, four Lib Dems and four old-fashioned Liberals whose slogan in the election was 'Save Our Hospital'. The alliance campaigning to save Kidderminster Hospital now commands a majority."

David Lock and friend

This unprecedented political upheaval in a not very tempestuous part of the world reflected a great wave of anger against the government's health policy in general and PFI in particular. Opposition was further encouraged by a report in June 2000 from the public policy unit of UCL. It exposed the devastating consequences of the huge extra bill for the PFI hospital in Worcester. Its costs, taken together with the accumulated deficits in the NHS in Worcestershire, "have forced the health authorities to cut hospital services across the county". The report went on: "While the catchment population of the new PFI hospital will rise from 280,000 residents to 380,000, acute admissions are projected to fall by between 21 and 37 percent of the average in England."

Prof Pollock went to Kidderminster on 25 May 2000 to announce the results of her research at a packed and enthusiastic press conference. How did David Lock MP respond? He wrote a long letter to Lord Young of Graffham, chairman of University College London's council, complaining of "several factual inaccuracies" in Prof Pollock's account and asking "whether Professor Pollock is justified in using public money to pursue her research in this manner".

In her reply to the university, Prof Pollock pointed out that not a single factual error had been identified and wondered whether Lock's letter was not "an implicit threat to academic freedom". The *Eye* article drew a scornful letter from David Lock alleging that Prof Pollock had somehow missed the provision of 600 extra hospital beds in his area. This drew another mild reply from the professor in *Eye* 1008. She repeated her conclusions:

- The cost of the PFI contract rose from £49m to £108m, with a further £8m for equipment again through PFI.
- The new facility will serve 100,000 more people but there will be 44 percent fewer acute inpatient beds.
- The "small matter of 600 beds he claims we omitted never featured in any of the health authority's published plans… Alas, as Mr Lock is surely aware, 400 of these are "community beds" with none of the consultant-led care of acute beds." This was obviously why they had been left out of the official calculations.

But Mr Lock was not finished yet. Several months later, in April 2001, he achieved the rare distinction of being named Man in The Eye (1026). Heading the citation was further evidence of Mr Lock's diligence in protecting his reputation with the help of the law. He had threatened the vice-chairman of Health Concern, Frank Baillie, with a libel writ for an article in the left-wing weekly *Tribune*. In the article, Baillie attacked Lock "for going for promotion instead of standing side by side with the people of Wyre Forest". The council's insurers refused to meet the cost of a libel action, and Baillie (who couldn't begin to afford the costs) felt obliged to issue a grovelling apology.

Even more surprising was Lock's reaction to an article in a small local magazine, *For You*, that reprinted the *Eye*'s articles on the PFI hospital as part of a longer article supporting the independent candidature of Health Concern's Richard Taylor in the 2001 general election. Lock phoned the company that produced the magazine and demanded another apology, damages and costs. He got neither. All these matters came to a head at the June 2001 general election in what the *Eye* called "the best election result by far" (1030). The new MP for Wyre Forest was none other than the Independent candidate Richard Taylor, former chairman of Health Concern, who got 28,487 votes compared to Lock's 10,857. In its first test by the electorate PFI had been comprehensively rejected.

HUNT BALLS

There was no sign that anyone in government took the slightest notice of the Wyre Forest result, however. Indeed, one of the most remarkable features of the PFI story is the length to which the New Labour government has been prepared to go to distort, twist and if possible ignore the rising tide of popular opposition to PFI — especially in the health service.

In March 2002, *Eye* 1050 told the strange story of plans to build a huge new PFI hospital in Birmingham to replace Selly Oak and Queen Elizabeth hospitals. As with all other such plans, they projected fewer beds, fewer staff and fewer services but more public money. The job of assessing public reaction to the proposals fell to the local community health council (CHC).

Lord Hunt

CHCs were set up by Labour in 1974 and were meant to be independent of the local health bureaucracy. The South Birmingham CHC, chaired by Ursula Pearce, circulated a leaflet through the area covered by both hospitals, setting out the PFI proposals and outlining an alternative based on public funding and public accountability. The leaflet asked people in their own time and at their own expense to respond. When 3,337 people did so, 3,159 favoured the CHC alternative and only 178 backed PFI.

When the CHC published these figures, the New Labour establishment went berserk. It issued three complicated consultation documents, none of which discussed PFI or its implications. They generated very little response: only 628 people replied at all, and less than half of these were from the general public. The CHC was not impressed and continued to speak out against the PFI proposals.

Ursula Pearce was then rather surprised to be summoned with her vice-chairman to the headquarters of the West Midlands National Health Service where she was told in no uncertain terms that CHCs had a duty to fit in with government policy and therefore had no business opposing the PFI hospital. She, her national organisation and her lawyers all replied that the job of the CHCs was precisely to be independent of government.

Ursula Pearce was further surprised to learn that among the supporters of the PFI hospital were officials of the Socialist Health Association, formerly the Socialist Medical Association that had campaigned so hard for the National Health Service 50 years

Tony Blair at home in the North East, extolling the virtues of PFI

previously. She eventually resigned in disgust from the SHA — but not before she noticed how many supporters of the PFI hospital, though unable to demonstrate any real popular support for PFI, had moved on to higher things.

Among the influential members of an advisory panel which came out strongly for the PFI hospital were the newly-ennobled Philip Hunt, the Bishop of Birmingham Mark Santer, Jeff Chantra and Khalid Mahmood. Before long Chantra was chief executive of the Good Hope hospital in Sutton Coldfield; Bishop Santer was vice-chairman of the University Hospital Birmingham Trust; Lord Hunt was parliamentary under secretary of state for health in the House of Lords; and Khalid Mahmood was in the Commons as Labour MP for Birmingham Perry Barr. Before long, into the bargain, community health councils were abolished.

Despite the popular hostility, the government's hysterical support for PFI grew. Boosted by another huge majority in the 2001 general election and more enthusiastic encouragement from their go-getting advisers, ministers embarked on a process which, they hoped, would commit every single public sector building project to the mercies of PFI.

At the Labour party conference in 2003, for instance, the bright young schools minister David Miliband blandly announced that all future school-building would be sentenced to PFI. His announcement came in the face of signs, already apparent by the election, of the calamity the PFI policy was hatching — especially in the hospitals whose construction had been hailed as such a triumph.

At the Edinburgh Royal, for example, the cost of PFI left a huge black hole in the finances of the Lothian health board — a hole that still threatens the future of the health service in the east of Scotland three years later. The auditor general for Scotland has exposed a deficit of £105m. Most of this is attributable to PFI at the Edinburgh Royal.

At Bishop Auckland, where the new PFI hospital was opened by local MP Tony Blair making suitably sweet noises about the PFI that had made the hospital possible, the air conditioning collapsed soon afterwards. There were many similar complaints, most of them noted in the *Eye*, in hospitals at Carlisle, Swindon and Halifax.

In west London, the PFI planners proposed the closure of two popular hospitals, the Royal Brompton and the Harefield, and their replacement by a huge new PFI hospital at Paddington basin. This profoundly unpopular project gobbled public money voraciously. The original estimated cost of £380m rose by mid-2003 to £800m, even before planning permission had been granted for the new hospital. One reason for the staggering increase was the host of advisers and consultants clustering round the project like bees at a honey pot. Tory MP John Randall found out in parliament that £3.2m had been spent on "advisers' fees".

As for education, the transfer of all the Glasgow schools to the private company Jarvis, singled out by Tony Blair for special praise in the 2001 election campaign, developed into a series of spectacular disasters, one of which resulted in a school's roof falling in. In another, three computers burst into flames and light bulbs exploded (*Eye* 1038 — for further disasters see Jarvis At Bay, page eight)

I.T. HITS THE FAN

Perhaps the most appalling series of PFI disasters occurred in the area of computing systems and information technology (IT) — always an area in which prodigious amounts of public money were wasted.

Many of the cock-ups — especially those involving the American computer company EDS, established by Ross Perot, the independent billionaire candidate in the 1992 American presidential election — have been exposed over the years in *Private Eye*. But under PFI, which transferred basic responsibility for the project from an elected authority to a private company, the disasters became much more frequent and expensive.

IT disasters had opened up another important argument in favour of PFI, its supporters claimed. For the system, they said, "transferred the risk" from the public to the private sector. Thus if a private firm cocked up, the private firm paid, whereas under the old system, where the government or a local authority was in charge, the cock-up would have to be paid for by taxpayers.

One of the earliest IT cock-ups dated back to the Tory government but involved the firm that did more than any other to help Labour in opposition: Andersen Consulting, then sister organisation of Arthur Andersen, later disgraced as auditor of the corrupt and bankrupt Enron.

Andersen Consulting won the computer contract for the National Insurance Recording System (NIRS2) for storing pensions records, but made an almighty mess of it. This led to continuous delays in the assessment and payment of benefits. The cost of the disasters, though deplored by committees of MPs, was never calculated and certainly never paid for by the company.

Eye 1001 reported how "Red" Dawn Primarolo, the paymaster-general who took over from the father of PFI, Geoffrey Robinson, explained to the Commons why Andersen Consulting should not have to pay for the mess. "It would not be sensible or cost-effective to seek further compensation from Andersen Consulting beyond the amount of £4.1m which was paid for delays in 1997 and 1998. I am satisfied that taking action against Andersen Consulting would prejudice the partnership relationship now established between it and the Inland Revenue."

The same edition of the *Eye* quoted Peter Holmes, Andersen's managing partner, who blandly announced: "The structure of PFI does mean that the contractor owns the intellectual property rights to the system and licenses the government to use the asset. Inevitably that means the balance of power is shifted to the contractor."

Perhaps unwittingly, Mr Holmes exposed a central weakness of PFI. His point was reinforced in a later *Eye* (1010) which quoted Elizabeth Astall, a partner at Andersen Consulting, telling a Commons committee that even if her firm failed to win a further contract to run the computer system, it would still want compensation which she modestly estimated at £100m for the intellectual property rights in the contract, plus another £14m for the software the firm had developed.

In vital computer contracts like this one, the balance of power, and the balance of risk, do not shift to the private sector. No government could possibly walk away from so vast a computer project as NIRS2. Nor could a government risk being sued in court for the intellectual property rights (or any other assets) it had so freely conceded. So invariably in such contracts it is the taxpayer, not the company, who has to fork out when a project falters or collapses which she modestly estimated at £100m even though the PFI contract transferred the supervision of the contract, and theoretically the risk, to the private firm.

The point was forcefully made by the usually timid national audit office in its report in August 2000 into the calamitous scheme to provide benefits payments cards via the post office — a PFI contract that lost the department for social security (DSS) and the Royal Mail more than £500m. The private company lucky enough to win the PFI contract was Pathway, a subsidiary of the giant computer company ICL. The NAO reported: "The purchasers [DSS and the post office] did not in the end demand damages from Pathway when the project began to slip. They felt this would not encourage Pathway to succeed and could deflect the firm's attention away from delivery to a legal battle."

The point about risk was raised by Sir John Bourn, the comptroller and auditor general. "Some risks," he said, "are too great for the private sector to absorb. As *Eye* 1010 commented: "Hence ICL never paid for its failure because the government was worried this might result in the whole scheme collapsing… which it did anyway."

The DSS-post office contract was not the only computer fiasco in which the government tied the taxpayers' apron strings to ICL. Just after the 2001 election, *Eye* 1032 highlighted the bizarre story of the Libra project, an attempt to computerise court records. Once again ICL was contracted, this time by the lord chancellor's department. Enthusiastic speeches were made by young ministers, notably Geoff Hoon from the department and Paul Boateng from the home office. Boateng called Libra a "significant step towards the integrated information systems which ties in with the government's determination to have a coherent criminal justice system".

Alas, the government's determination did not stretch to controlling the Libra project, which was indefinitely postponed though it had cost the taxpayer more than double the original value of the contract, £136m. While the taxpayer once again bore the brunt of the fiasco, ICL was swiftly swallowed by the Japanese computer company Fujitsu, which at once started to win further PFI contracts from the government.

SIEMENS STAIN

Two other historic computer disasters were the responsibility of another top European company, Siemens.

As early 1998 *Eye* 960 warned that the £77m PFI scheme to computerise immigration and asylum claims was a year overdue. The scheme eventually collapsed completely, but the government paid Siemens in full under what even the national audit office called "a novel payment mechanism".

This was rather an understatement, since the real reason Siemens got paid was because it had apparently passed on "new technology milestones". The minister in charge of the contract, Mike O'Brien, claimed there had been an "open competition" for the contract. In fact there were just two bidders: Siemens and Andersen Consulting (later renamed Accenture), which had been disqualified because of continuing difficulties with NIRS2.

Siemens' troubles with immigration and asylum programmes were dwarfed by another of its big computer PFI projects at the passport office. How upset were ministers with Siemens as a result of these expensive fiascos? One answer came this year when the government appointed a computer king to examine PFI projects for British companies in Europe. His name? Alan Wood. His company? Siemens.

The truth is that the big companies and consortia that win PFI contracts have the government and taxpayer over a barrel. And one way that companies, but not the government, can worm their way out of their responsibilities is by the time-honoured method of bankruptcy. The concept of "limited liability" is as central to the modern corporate state as it was in the heyday of Victorian capitalism. It enables a company to go bust without too cruelly affecting its directors or shareholders. If a company running a PFI operation goes bust, it obviously cannot meet any risks it undertook to shoulder.

In November 2001, the building firm Christiani & Nielsen went bust. Down the drain went the firm's undertakings, in a PFI contract, to run schools and colleges in Newbury, Berkshire. The *Eye* noted (1017) that one man who did not suffer too harshly for his connection with the firm was Alan

WHY PFI DOESN'T ADD UP

AS these two tables from the public health policy unit at University College London's School of Public Policy demonstrate, the private finance initiative in the NHS has been particularly bad for the nation's financial health.

Indeed, in the paper *Pump-Priming the PFI: Why are privately financed hospital schemes being subsidized?*, Allyson Pollock (left), professor of health policy research at the school, and Declan Gaffney conclude: "The PFI has had the effect of raising the costs of infrastructure development in the health service. The assumption that higher capital costs would be offset by savings resulting from the involvement of the private sector has proved incorrect.

"Rather, NHS trusts and health authorities have had to make savings on other budgets in order to make the high costs of investment affordable."

Annual revenue implications of capital costs for 11 PFI hospital schemes comparing costs before and in the first year in which the PFI scheme is operating

NHS Trust	Before PFI (Capital charges as % of income 1998-9) of operations)	After PFI (Capital charges + availability fee as % of projected income in 1st year)
Dartford & Gravesham	6.7	32.7
Swindon & Marlborough	3.8	16.4
Greenwich Healthcare	2.1	16.2
West Middlesex University Hospital*	9.3	15.5
Carlisle Hospitals	4.0	14.7
Hereford Hospitals	3.8	14.6
South Tees Acute	5.6	13.2
Calderdale Healthcare	3.4	13.1
The Dudley Group of Hospitals*	8.3	12.8
University College London Hospitals*	6.2	12.5
Worcester Royal Infirmary	5.3	12.4

* Refers to 1999-2000

All calculations include payments to Treasury on existing and retained estate.

Department of Health. *Expenditure Questionnaire 2000. Memorandum to the Health Committee, NHS resources and activity.* London: Stationery Office, 2000.

Department of Health. *Memorandum to the Health Committee: Public Expenditure Questionnaire 2001.* London: Stationery Office, 2001.

Increase in costs from outline business case (OBC) to current – 1999/2000

Trust	OBC cost (£m)	Current cost (£m)	Change (%)
Bishop Auckland	26	52	100
Bromley	80	120	50
Calderdale	55	77	40
Carlisle	48	63	31
Dartford	97	137	41
Hereford	50	63	26
Norfolk	90	200	122
North Durham	60	96	60
South Manchester	40	89	123
South Buckinghamshire	35	38	9
South Tees	65	106	63
Swindon	45	148	229
Wellhouse	30	40	33
Worcester	49	116	137

Crane, a former Labour councillor who was chairman of Christiani & Nielsen. He became chairman of the government's "Movement for Innovation", described by the *Eye* as "a quango set up to create self-sustaining continuous improvement leading to world class high performance and increased profitability".

Another embarrassing collapse was that of Ballast UK, liquidated subsidiary of the Dutch combine Ballast Nedam. Six schools in Scotland were immediately affected as their computers, library books and even school desks were repossessed by sub-contractors in a collapsed PFI scheme (*Eye* 1095). The risk, naturally, could not be born by the liquidated company, which had at most half a million quid in the kitty to pay creditors a total of £31m. So the risk passed to the wretched education authority — or the children who begged for a reprieve from their examinations (see *Eye* 1098).

BAX TO THE WALL

Bankruptcy, however, has not been the only way a company or public body can pressurise the government into bailing it out of a PFI mess.

Eye 1068 publicised a desperate letter from Councillor Judy Bax, executive member for life-long learning at Haringey council, to the then secretary of state for education, Estelle Morris. Bax complained that the council, which had signed a contract with Jarvis to maintain all its secondary schools, was new to PFI projects. As a result "the scope of the project did not include furniture and equipment for newly-constructed buildings, complete access for wheelchairs, comprehensive cabling, IT provision and building cooling systems to reduce solar gain." All this, she reckoned, would cost an extra £2m.

The government, she noted, had been unwilling to shell out the money, but if it didn't, she warned, it might be difficult to hold back the groundswell of local opposition to PFI and even more difficult to introduce PFI into the refurbishment of Haringey primary schools. The result of this subtle argument was immediate. The *Eye* reported: "The threat worked and the government (taxpayer) coughed up."

As time went on and the companies behind the early PFI schemes fell deeper and deeper into difficulties, the government became more and more generous with the public money it was meant to be saving. Octagon (Laings, Barclays and Serco) was one of the first PFI consortia. It won the plum contract to build and run the Norfolk and Norwich hospital. In 2003 Octagon complained about the crippling cost of the job it had freely taken on. In December that year, the *Eastern Daily Press* reported a "re-financing deal" between the NHS and Octagon. The results of this were a fine example of PFI even-handedness between the private contractor and the health service. Octagon got an extra £70m immediately, and the health service got an extra £30m over 30 years.

The paper reported that the deal "comes as the hospital faces soaring waiting lists, acute bed shortages and an overflowing accident and emergency department at the Colney site". The North Norfolk Liberal Democrat MP Norman Lamb was quoted as saying: "Is this value for money for the taxpayer? The answer is: No."

PFI: THE PRICE IS ALWAYS RIGHT

PERHAPS the greatest beneficiaries of PFI are the accountants, consultants and advisers who have buzzed around the PFI honeypot ever since they first promoted it.

For example, in the Newcastle Estates Development Project, in which Amec agreed to take over and develop the vast department of social security offices in the north-east, financial adviser Dresdner Kleinwort (those merchant bankers again) got £404,000 – four times the tender price.

Meanwhile the bill from Masons, a law firm, shot up from £70,000 to £2,355,000. All this was down to PFI; but the national audit office (NAO), which published the figures, admitted it was "unable to say whether the deal is likely to deliver better value than a conventionally-financed redevelopment of the estate" (see *Eye* 993).

The reason for the NAO's difficulty was that on that occasion there was no "public sector comparator" to set alongside the private spending spree. But even in cases where there was a public sector comparator, it could still turn into a goldmine for the accountants.

The classic case was the West Middlesex hospital PFI. There, the NAO discovered that the public sector comparator proved that the public option was *better* than the private one. So KPMG, the accountants, "reappraised" the figures, shoved in some highly questionable risk factors – and, lo and behold, suddenly the PFI option became cheaper (see *Eye* 1069).

As George Monbiot outlined in the *Guardian* on 18 June 2002, there are a number of devices by which the public sector comparator can be conveniently (and inaccurately) tweaked to make it look more expensive than the private sector alternative.

THE LUCKY COMPANIES

JARVIS AT BAY

Which lucky companies got the PFI contracts? Some were old-fashioned construction firms and banks like Laings and Barclays. But soon other less well-known companies were queuing to join the PFI bandwagon. One of the first out of the blocks was Jarvis — a name that in a few years became a by-word for bungling and ripping off subcontractors.

The speed with which Jarvis gobbled up PFI contracts was breathtaking. By early 1998 its railway subsidiary had secured 70 percent of track maintenance contracts from Railtrack, and its education subsidiary was bidding heavily for contracts to run local authority schools. Its senior executives grew vastly rich from these early triumphs. Chief executive Paris Moayedi earned £315,000 a year in salary and another £2,344,000 in share options. Finance director Henry Lafferty did even better. He got an astonishing £3,516,000 from buying and selling his share options.

From the early days of the PFI bonanza, the firm snuggled up close to the Labour government. At Labour's 1997 party conference in Blackpool, Jarvis paid for something called the "Labour leadership campaign team". The speakers were John Prescott, deputy prime minister, and Hilary Armstrong, the minister who brought PFI to local government. Jarvis also kept a Labour lord — Lord Hogg of Cumbernauld — on the payroll.

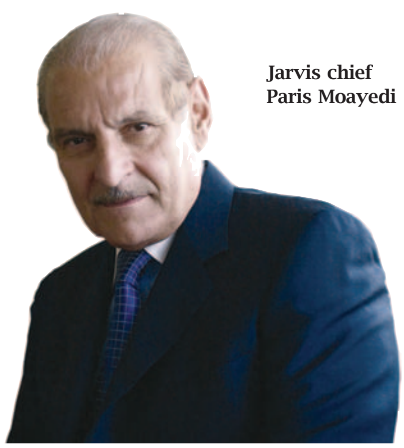
A lot of Jarvis's success in the early years was down to the firm's talent-spotters, who picked out and recruited influential businessmen like Bob Clarke, former development officer for British Rail, and Bob Pirie, former director of corporate services at Haringey, where Jarvis bid successfully to build and run several secondary schools.

A few months later *Eye* 972 pointed out more advantages for Jarvis. The firm was being advised by public relations specialists Citigate. Citigate was a sponsor of the Labour party and had booked a table at the gala dinner at the previous year's party conference.

Another important qualification was what the *Eye* called a "dodgy safety record". Jarvis was being prosecuted for "a dreadful railway re-routing cock-up between Coventry and Hertford." The *Eye* reckoned that Jarvis was running neck and neck with Balfour Beatty in the contest for the two juicy PFI contracts on the London Underground and Haringey schools. The reckoning was slightly in favour of Balfour Beatty, the *Eye* pointed out, because of the enormous amount of time that company's executive Colin Ostler had spent going round the world looking for contracts in the distinguished company of Labour's minister for London and construction, Nick Raynsford. In the event Jarvis triumphed at Haringey.

It was four years before the result of that triumph became fully clear. *Eye* 1072 (24 January 2003) led with a comment on an audit commission report that studied the first 17 PFI contracts for local authority schools. The commission "found that in every single one there was no improvement on the traditional method of procurement. In some cases the traditional method would actually have been preferable." The schools were not cheaper. The contracts were not completed any quicker. And there certainly wasn't any transfer of risk (see Cllr Judy Bax's letter to education secretary Estelle Morris, referred to previously).

Tactfully the commission did not name any of the contractors. But the *Eye* could reveal that the report was based on the first wave of school projects that were dominated by Jarvis. Despite the report, however, the government continued to name a consortium that included Jarvis as the preferred bidder for the privatised track of London Underground.



Jarvis chief Paris Moayedi

Jarvis's historic record on the privatised railway achieved a lot of unfavourable publicity after the crashes at Hatfield and Potters Bar. In a "Jarvis special", *Eye* 1094 disclosed further Jarvis triumphs in the field of education.

Students turning up for a new year at Lancaster University "found themselves wandering around in the dark on wet floors tripping over building materials". The new 402-room Graduate College there had been built by the Jarvis University Partnerships Programme under which the firm will provide and manage for the next 38 years another 1,956 rooms for the luckless university. In the brand new graduate block, the external locks didn't work (the authorities had to post security guards outside), water from the showers poured into the bedrooms and builders' detritus littered the accommodation.

At the same time, at the brand new Jarvis/PFI-built Jewish Free School in Kenton, north London, students had to be sent home because light fittings were about to fall from the ceiling. It was obvious that the school would be the perfect venue for a conference on 26 November 2003 entitled *PPP Education: Delivering Schools for the Future*. The same issue of the *Eye* included the complaints of Jarvis sub-contractors who had installed alarm systems in PFI-built schools in Richmond, Surrey. Though there was no complaint about the work, three months had passed and the contractors had still not been paid. One of the sub-contractors had opened a website called Screwed by Jarvis.

Perhaps the most revealing story about Jarvis appeared in *Eye* 1088. It was a story of petty fraud and a keen Grimsby Town supporter called Stephen Venney. Mr Venney had wanted to take his family on expensive holidays in Turkey and Tenerife, so he stole a few thousand pounds from Immingham Conservative Club of which he was a respected member. He was prosecuted and sent to prison for 20 months.

A few months after he came out, he applied for the prestigious job of finance director of Jarvis Rail, a company enjoying the fruits of PFI contracts all over the network. So tight was security at Jarvis that Venney was appointed. He immediately set about forging closer links between Jarvis and Grimsby Town FC. No sooner had he clinched the deal (the lucky players still have JARVIS emblazoned on their shirts) than the local paper published the sad facts about his past and he hurriedly resigned.

By early 2004, the great days of Jarvis were coming to an end. Jarvis lost all twelve of the new NHS "Lift" contracts for which it bid. A name change was obviously called for, and the firm's health subsidiary got a new but not entirely accurate title, PatientsFirst. Not long afterwards, Jarvis changed the name of all its operations to the silly New Labourish rubric Engender — quickly nicknamed, undoubtedly more accurately, Endanger.

AMEY AMISS

Another company that made many millions from PFI was Amey.

It soared into the new PFI market, strongly backed by PricewaterhouseCoopers (PwC), the biggest accountancy firm in the country. It was PwC, for instance, which persuaded Glasgow and East Renfrewshire councils in Scotland to hand over the running of their schools to a consortium led by Amey. The public private partnership (PPP) for the Glasgow schools led to widespread protests in the city, especially over the closure of swimming pools.

To make matters worse for the company, the Scottish government auditors were unhappy when they studied the "public sector comparator" in which private consortia bidding for PFI contracts are expected to show that their project is cheaper than traditional procurement would have been. The auditors concluded: "The result of the public sector comparator test does not indicate compelling evidence that the PFI deal offers the most economic option compared to conventional procurement."

Few paid any attention to that warning. Amey and PwC were a convincing double act and went on winning PFI contracts to run schools all over the country, most notably in the London borough of Waltham Forest. Into the bargain, and just to prove the firm's close association with the government, Amey was awarded a £35m, 12-year contract to run an "accounts service" for the department of trade and industry (prop: Patricia Hewitt, former head of research at Andersens).

In the same issue of the *Eye* (1059) that reported the problems in Glasgow schools, there were warning signs that all was not well with Amey. At the beginning of 2002, Amey was knocking at the door of the Footsie top 100 companies in Britain. But by late summer the share price had slumped. The firm was obliged to admit that its stated profits of £55m were in fact, ahem, losses of £18m. How had such a glaring mistake been made?

Amey put most of the blame on something called Urgent Issues Task Force Note 51, a note issued by the accounting standards board. This specifically prevented an accounting trick which companies like Amey had used to massage their figures into something very different to the reality.

One way they did this was to pretend that the vast costs of bidding for a PFI contract were "investment" and therefore need not be set against profit figures. This was nonsense and should not happen again, the note insisted. So Amey said publicly that because of the accounting standards note, with which it obviously disagreed, it had to admit that a hefty profit was really a hefty loss.

Even this turned out to be deception. In August 2002 David Miller, Amey's finance director, resigned. He was replaced by Michael Kayser. Kayser soon discovered that the Amey accounts were worse even than had appeared in the summer crisis, and that the firm's prodigious losses were caused by much more than just a note from the accounting standards office. As soon as he absorbed the state of the accounts, Kayser resigned too.

The directors brought in a partner from Deloitte and Touche who insisted that £122m — an enormous sum for a company the size of Amey — should be written off. The 2002 Amey accounts indicated that the huge write-off was necessary for reasons far wider than the accounting standards note. The accounts referred to "write-downs of construction work in progress balances and forward loss provision for which previous optimism as to the recovery… has not been born out in practice".

In 1097 — the first issue of 2004 — the *Eye* revealed exclusively that Amey had set up "a subsidiary appropriately called Treasure Park, half-owned by another company run by a businessman not entirely unknown to Brian Staples, Amey's chief executive. Because this arrangement was known as a JANE ('joint arrangement not an entity') Amey hoped to avoid losses on its Croydon Tramlink PFI catastrophe and at the same time book some profits to close the £55m hole." This it plainly failed to do.


Brian Staples

Chief executive Staples took a pay-off of a quarter of a million quid and went to join the board of a company called IMI and sit on the audit committee there. Amey, however, had lost an enormous sum of money, not just by fiddling the PFI books but also as a result of the deranged optimism that plagued a lot of construction companies at the time.

Part of the reason for this was the absurd faith placed in the company by the PFI-crazed New Labour government. For instance, just as its 2002 financial difficulties were being unveiled, the Amey board was joined by a New Labour leader of utmost prominence. Baroness Jay had been New Labour's leader in the Lords and a member of the cabinet. She joined Amey when the company most needed her prestige. Among her fellow directors was former Tory secretary of state for education, John Patten. Patten's abilities had been questioned by John Major, former Tory prime minister, who suggested his problems in the education department had brought about something close to a nervous breakdown.


Baroness Jay, who joined the Amey board

Patten's job at Amey was to keep a reliable eye on PFI contracts in schools. In 2003, Amey posted a loss of £130m and was duly gobbled-up by a Spanish building company called Ferrovial. Sceptics in the City were surprised that the Spaniards would want to buy a clapped-out loss-maker like Amey. But the Spaniards' enthusiasm was easy to understand. Amey was still part of a consortium bidding for a PFI contract to run the London tube. The cream from the tube would easily drown the losses of the past. Thus was Amey's survival due in no small part to the chancellor, Gordon Brown, described in the *Eye* as "the only person left in the country who still believes the London Underground should be flogged off to companies such as Jarvis and Amey".

There was, however, one other person who, despite all the evidence to the contrary, continued to believe in the magic of Amey. In August 2003, at the depth of Amey's misfortune, *Eye* 1087 reported that Nigel Crisp, head of the NHS, had "put the American director of a clapped-out privatisation firm in charge of Tony Blair's 'fast track' hospitals". Ken Anderson, Texan-born development director of Amey, was "the new commercial director of the NHS" whose job is to tempt private entrepreneurs with records as impressive as Amey's to run the new privatised diagnostic and treatment centres.

BLAIR BABE RUTH MAKES A CLAIM

By 2003 PFI dominated a substantial area of British business. No fewer than 570 PFI deals had been signed for business worth a total of more than £50bn, though arguments rage on about the value of these deals.

A great deal of effort was made, however, especially by the publicity offices of the four big accountancy firms that made the most out of PFI, to demonstrate that most PFI schemes finished on time with their projects intact and sound. Indeed, in a debate on 2 April 2003, Ruth Kelly, financial secretary to the treasury, quoted from a national audit office report whose conclusion, she observed, was as follows: "Before PFI, 70 percent of projects were late and 73 percent over budget, but under PFI, the situation was dramatically reversed: 76 percent of projects were on time, and 78 percent within budget. What is more, where projects were not delivered on time, the private rather than the public sector has borne the cost."

This rosy picture did not take into account the treasury's method of calculating the cost of PFI contracts. Many of the calculations were made from the moment the contract was signed, not from the original outline business cases which, as we have seen, grew hugely before the contract was finally agreed. Nor did they allow for the fact that PFI contracts for roads were usually easier to complete on time than others involving much more complicated day-to-day human activity like hospitals and schools. But above all the NAO figures did not examine the long-term price of these PFI projects: the heavy burden of debt weighing down on hospital trusts, ministries, other government agencies and local councils from shelling out year after year for the PFI projects without any control over the facilities.

As we have seen throughout this survey, there were many schemes, especially in the National Health Service and education, where the experience of PFI was precisely the opposite of the picture presented by Ruth Kelly.

But one conclusion surmounts all others. The PFI hysteria in the Labour government led to an enormous transfer of power in Britain: from public, elected authorities to private unelected corporations. Into the bargain, the corporations were guaranteed a flow of public money that would continue for at least a generation, whatever happened to the original product. This flow of money cannot be cut off and will increasingly wear down the authorities providing it. Under the old system of procurement, there were of course massive cost over-runs from which most of the big construction companies, their accountants and finance houses siphoned off huge profits. The chief difference between the old system and the new is that under PFI the public debt to the private provider continues relentlessly for at least a quarter of a century.

We are still at the beginning of that time scale, and no one can predict what the eventual effect of this vast indebtedness will be. The early signs — for instance in the continuing arguments over the Edinburgh Royal Infirmary — are not hopeful. We know enough about these schemes already, moreover, to expose the myth that these PFI schemes transfer risk from public to private sector. Again and again, as the schemes extend further and further into areas that cannot be abandoned by government, the risk comes back to where it started: with the public authority that transferred the power in the first place.

THE GREAT PFI SELL-OFF

Very recently, a new development has further shaken any confidence the public may have had in these most unpopular schemes. The consortia that developed the big PFI projects have been selling off their stakes to make more money to invest in more PFI deals.

Eye 1095 reported the sale by Carillion of its share in the lucrative PFI deal in one of the first hospitals built under PFI, Darent Valley in Kent. The price it got was £16.4m, four times its original investment. The buyer was Barclays UK Infrastructure fund, with obviously close connections to Barclays Bank. Two issues later (1097) the *Eye* reported: "The extent of these sales has now reached staggering proportions. A private equity group called Star Capital has acquired stakes in 25 PFI projects worth around £2bn. Why this sudden rush? One reason is probably the 'substantial shareholdings' tax exemption in Gordon Brown's 2002 Budget. This absolves companies selling shares in other companies in which they have at least a 10 percent stake from paying tax on any capital gains they make."

Considering the huge capital gains the companies did make on these sales, this tax exemption was obviously a big incentive to the companies to flog off their PFI stakes. But there were also other reasons the international funds wanted to buy them. The PFI stakes gave the funds what they needed most: a regular stream of income from British public authorities that cannot go bust. So while the PFI corporations made a hefty untaxed capital gain on the sale which they can invest in further PFI deals — and so on, ad infinitum — the funds got a steady income. Both prospered accordingly. Henderson Global Investors reckons that "once operational, PFI concession companies deliver average running cash yields of 10 to 12 percent per annum on projects acquired in the secondary market" — a nice little earner by any standard.

But what are these funds and where are they registered? The main funds are run by three private equity companies, Barclays Private Equity, Innisfree and Star Capital. The funds they manage pool money from some of the richest people and institutions in the country (and outside it), who are not the sort of people likely to have any use or concern for the state of the schools and hospitals they are snaffling up in the great PFI bonanza.

Trailblazer? Darent Valley Hospital, Kent

The funds don't advertise where they are registered and don't publish detailed accounts. Many are set up as "limited partnerships" — a neat device which limits the investors' risk in the projects and at the same time ensures that the funds don't have to disclose who owns them. They are well and truly private and much more so than the companies selling them the PFI stakes. They are private in the sense of "Private — Keep Out!"

They are also huge. Innisfree boasts £5.7bn in its four private equity funds. The money is funnelled into the funds by "managers" such as Hermes, Norwich Union and Henderson Global Investors. Included in this huge reservoir of wealth are majority stakes in the £450m Derby hospital PFI scheme and the £50m Birmingham schools PFI scheme. Barclays Private Equity has 30 projects with a capital value of more than £2bn. Managing these vast funds is no doubt made easier by the fact that two former members of the Tory government's private finance panel, Chris Elliot and David Lindsay, sit on the fund's board.

In the same way Star Capital, which doesn't disclose the PFI projects it has snapped up, is backed by the Royal Bank of Scotland, whose board is graced by Sir Steve Robson, former top privatiser in the treasury and still a member of PUK, the privatised arm of the former treasury task force. The City ranking for this operation can be measured by the fact that Star Capital's chief executive Tony Mallin gets over £600,000 a year. So all these funds, their investors and advisers, do very well out of this latest fashion for flogging off PFI stakes.

But what about the people most affected by the PFI sales in the first place? One of the central arguments for PFI was that it leaves the public sector providing public services (like the NHS) and the private sector "doing what it does best"— ie owning and running buildings and services. But the recent fashion for selling stakes to private funds removes the PFI companies from any responsibility for "doing what it does best". Responsibility for running of the services, schools and hospitals, for instance, passes with the sale of the stakes from the contracting companies to mysterious and remote private funds. How interested are they in mending a leaking school roof or a hospital operating theatre?

For an answer, hark once more to Henderson Global Investors. It insists on "the ability of the management and board of the concession [PFI] company to ensure that its operating costs and the costs of planned maintenance are managed in accordance with, or better than, the assumptions that the purchase was made on". In other words, cut costs where possible. Moreover, "the portfolio should be actively managed to ensure that the performance of the investments are optimised, and all operational, financing, tax and accounting efficiencies are effectively identified and extracted". In other words, milk the newly-bought PFI stake all you can.

The point is quite clear. The users of the assets consigned to PFI are even more distant from the people responsible for them than they were when the PFI deal was first made. It was bad enough when identifiable companies, registered and paying tax in Britain, owned and managed the assets. But now the owners and managers are hidden from public view, heaven knows where.

There are signs in early 2004 (as this is written) that some senior civil servants who

OFF BALANCE

THE STRANGE CASE OF THE VANISHING HOSPITALS

LONG before he took office, Gordon Brown let it be known that he wanted to be remembered as the Iron Chancellor. In a debate in April 2003, Mark Hoban, Tory MP for Fareham, suggested that a more suitable nickname might be the Enron Chancellor.

Enron, a huge international energy trading scam run by a friend of President George Bush, went bust in 2002. Its accountancy firm, New Labour favourite Arthur Andersen, was later shown to have specialised in a system of "off balance sheet" accounting. By the rather simple device of taking deals and assets off balance sheets, Enron was able to pretend that it made healthy profits (and, incidentally, managed to keep regulators and inquisitive journalists off its back).

Mr Hoban's rather cheeky new name for Gordon Brown arose, he suggested, from the way the government accounted for PFI projects. In the old days of public procurement, when the government built a hospital or a school, the asset appeared on the government balance sheet and had to be paid for out of taxation. But under the PFI system the asset does not appear on the government balance sheets. So the cost of the project is not counted as government spending and the government does not have to borrow money to pay for it.

There can be no doubt this device was the chief reason for New Labour ministers' almost evangelical enthusiasm for PFI. They could build hospitals and schools and, although they would be paying for them for at least a generation, they would not have to count the money they shelled out as public expenditure. More than anything else, this made it possible for Brown to keep his promise not to spend more for at least two years than the Tories had done.

Whoops! In September 1998, when Geoffrey Robinson was still paymaster-general, the accountancy standards board – the body that sets out accountancy rules in Britain – rudely threatened the whole process. The board stated categorically that the capital value of PFI schemes (and the related borrowing) *should* appear on the government's balance sheet. Anguished negotiations followed and ended in a compromise.

In June 1999 the treasury issued its guidance on how to account for PFI transactions. These guidelines went to the heart of the original rationale for PFI: the transfer of risk to the private sector. It was agreed that if the risk was genuinely transferred to private consortia, nothing need appear on the government balance sheet. Naturally, the government wanted as many as possible of the new PFI contracts taken off balance sheet, and this was achieved. On 7 November 2002, in answer to a question from Matthew Taylor, then Liberal Democrat spokesman on treasury matters, Paul Boateng, chief secretary to the treasury, gave a list of PFI contracts operational at the end of the 2001-02 financial year and the accounting treatment that had been adopted for them. Of the ten hospital contracts mentioned, nine were off balance sheet. These included the new Norfolk and Norwich hospital (capital value £158m) and the Queen Elizabeth Hospital in Woolwich (£118m).

So all these projects were not accounted for in the government accounts. But here's a strange fact. They are not accounted for in the accounts of the consortia either. There is no reference on the balance sheet of Octagon, the consortium that built the Norfolk and Norwich hospital, of any such hospital. Indeed, the *Eye* understands that none of the big PFI hospitals taken off the government balance sheet appear on any balance sheets of the consortia that built them. They have simply vanished into a black hole. Why?

Hello, cheeky: Mark Hoban in the Commons

One answer may be a new tax dodge called "corporate trader status", sanctioned by the treasury in late 2003 and keenly promoted by the big accountancy firms. If a company can show corporate trader status, it can get tax relief on the entire cost of a PFI project, as opposed to the 30 or 40 percent it would otherwise get relief on.

In the case of the Norfolk and Norwich hospital, corporate trader status would save the company (and cost the taxpayer) £30m to £40m. The auditor of Octagon is KPMG, which advertises its wares on its voluminous website and is not apparently too nervous about the allegations of conflict of interest between auditors and tax advisers that so damaged Arthur Andersen over Enron.

Among KPMG's other skills, it boasts, is an ability to help PFI companies which own property and evaluate "whether the property could be accounted for as fixed assets or financial assets on the company's balance sheets and the effect this will have on the tax position and the timing of tax liabilities."

To achieve corporate trader status, companies cannot keep the assets built by PFI on their books. And under accountancy rules they can only keep them off if they don't carry the risk of the PFI deal. So the companies like Octagon that keep the assets off their balance sheet are saying that the risks of PFI stay with the taxpayer, thus defeating the primary objective of PFI and effectively calling the government accountants incorrect into the bargain.

retain an element of responsibility for what they do, are growing worried about the consequences of PFI. The gross rise in the estimated cost of the proposed hospital in Paddington Basin, for instance, has led to further inquiries by the treasury and the NAO before the project goes ahead. In late 2003, a former employee at the National Physical Laboratory at Teddington, Middlesex, rang the *Eye* with details of a staggering PFI horror story. The whole ultra-sophisticated new building was due to be in place to celebrate the millennium in 2000, but after a series of design disasters it was still unfinished. Up to now, our informant said, the private sector had taken most of the risk. Laing Construction had been driven to the edge of bankruptcy and SG Bailey had lost about £10m.

As they dodged the private sector's complaints and demands for some sort of government bail-out, officials at the DTI grew nervous of PFI projects for such complicated projects. So when in 2002 the government announced that it was backing a new scientific facility at Didcot, Oxfordshire, it inspired what our source called "a wave of panic at the DTI in case this scheme too was consigned to PFI".

The magazine *Building* revealed: "The DTI intends to retain strict control over the scheme to avoid a repeat of the problems of the National Physical Laboratory at Teddington." The *Eye* rang the DTI to ask if the Didcot project was going to be built under PFI and got a sharp reply: "No this is not a PFI project."

So while ministers such as chancellor Gordon Brown and schools minister David Miliband remain firmly in favour of PFI, behind their backs some officials are beginning to regret that they ever got into the mess in the first place. How long they can keep their doubts to themselves and how long PFI will go on delighting New Labour ministers, is not at all clear.

What is already clear is the awful legacy that PFI has left behind. Is it cheaper for the taxpayer? No it is not. In every area where it has been adopted it has cost more, and will go on costing more. Has it led to more dependable buildings? No it has not. The PFI buildings are every bit as prone to disaster as buildings constructed by any other method. Has it "saved" public spending? Only by skilful manipulation of what a former Labour frontbencher warned would be "financial sleight of hand" and "deceit". "Borrow more and charge more" will forever more be the PFI slogans of government, even if that means wholesale abdication from responsible accounting and eventually from all democratic government.

Additional reporting and research by Solomon Hughes, Jane Mackenzie and Sue Roccelli.