Twenty years on from the introduction of the private finance initiative (PFI), DEXTER WHITFIELD examines how the transfer of ownership and financing of our schools, hospitals and other public infrastructure to private corporations is undermining democratic accountability and siphoning off much-needed public money – and how it's set to get worse under Tory PFI plans

Fingers in the PFI

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Step into any recently built school or hospital in the UK nowadays, and the chances are that, despite its nominal status as a public amenity, it will be owned by and have been built by the private sector, as a private finance initiative (PFI). PFI was introduced by the Conservative government in 1992 and New Labour turned it into the only public investment show in town during 1997-2010, using it to keep the cost of building projects off the public books.

It contributed a good many shiny new assets for the public sector. But like many boom-time aspects of the British economy that revolved around easy credit, PFI's star has fallen post-crisis as the liabilities side of the public balance sheet has come into sharp focus, highlighting the mountain of debt and punitively high interest repayments with which the public sector is now saddled. The time should be ripe to abandon this flawed model, but instead it is being rebranded.

Turbulent times for PFI

PFI infrastructure projects have had a turbulent time under the coalition government. It abandoned the £55 billion Building Schools for the Future programme in July 2010, scrapping 715 planned projects. Then the public accounts committee weighed in with a highly critical account of profiteering in the sale of share stakes in PFI project companies, and expressed major doubts concerning value for money.

The coalition's austerity programme also imposed severe constraints on infrastructure investment. The year-long Treasury review of PFI, commencing in late 2011, led to more delays and uncertainty on top of those caused by the financial crisis. Meanwhile, bank debt had become more difficult to secure and pension funds, insurance companies and other investment funds were cautious about filling the gap, because they rely on stable, long-term investment.

The volume of European infrastructure projects reaching financial close in the first half of 2012 was the lowest recorded in the past decade. The capital cost and number of signed contracts in the UK in 2012 is forecast to fall back to its 2009 level, a third of the pre-crisis rate.

Despite this decline, the Treasury still identified 39 UK PFI projects in schools, hospitals, highways and waste management with capital costs of £5.4 billion (and total costs of about £21.5 billion) in procurement at March 2012. And while new-build project deals have slowed down, speculative trading of shares in public-private partnership (PPP) projects have mushroomed and offshore infrastructure funds had little problem raising equity for the activity.

Pointing to new infrastructure as a means of driving economic recovery, the coalition responded in late 2011 with a £200 billion five-year UK infrastructure plan, but this was limited to economic infrastructure (energy, transport, waste, flood, science, water and telecoms). It also set up Infrastructure UK (IUK) to coordinate the planning and prioritisation of infrastructure projects and to improve value for money. Treasury-based, its advisory committee consists of permanent secretaries from the key infrastructure departments and, predictably, chief executives of PFI companies, such as Balfour Beatty.

In the health service, meanwhile, in early 2012, the government agreed to a £1.5 billion bailout to seven NHS trusts that had severe difficulties meeting their PFI commitments - paying off the private debt and interest used for new facilities. Twenty-two NHS trusts were reported to be confronting the same problems.

Wider costs and consequences

The fact that, less than two decades into the experiment, PFI has brought several NHS trusts to the verge of bankruptcy, should provide a moment for political leaders to reassess its metrics. The problem with PFI is not just the financial burdens it imposes.

It has created new markets and new pathways to privatisation, eroded democratic accountability and transparency, and enforced changes in the role of the state. PFI helps to embed the private sector in the management of public infrastructure and ensure in-house provision is no longer the default option.

The public sector's loss was others' gain, since it created new kinds of financial markets and expanded opportunities for management consultants and law firms. A secondary market has mushroomed in the sale of equity in PFI project companies (762 projects in 281 transactions worth £5.6 billion since 1998). The average annual return on the sale of equity in UK PPP project companies was 29 per cent during 1998-2012 – twice the 12-15 per cent rate of return agreed with the public body when the contract was signed.

New forms of 'partnership' are emerging between state and capital as a result of PPPs. Construction companies and financial institutions have exploited the risks inherent in infrastructure projects to demand legislation and contracts with the state that minimise their risks and maximise opportunities for profit.

The introduction of the £40 billion UK guarantees scheme in July 2012, follows in this pattern. It was designed to 'kick start critical infrastructure projects that may have stalled because of adverse credit conditions' (HM Treasury, 2012). The guarantees can cover key project risks such as construction, performance or revenue risk, despite projects already having a high degree of security by being entirely publicly funded. New EU 2020 project bonds financed by the European Investment Bank serve the same purpose.

These 'partnerships' amount to corporate welfare. The government has supported this not just through cosy contracts but by turning a blind eye to the rapid growth of offshore infrastructure funds, which now account for more than 75 per cent of PPP equity transactions. Five funds have 50-100 per cent equity ownership of 115 PFI projects. The result is a significant loss of tax revenue.

PPPs have given privatisation new pathways, such as the transfer of public services to trusts, arms-length companies and social enterprises; financial mechanisms to enable public money to follow patients and pupils or into personal budgets that allow service users to choose their own provider.

The role of the state is being reconfigured towards commissioning, procurement, and regulation rather than delivery of services. In the process, democratic accountability and transparency are being eroded.

PF2: a new era?

The financialisation of public infrastructure and services, in parallel with personalisation, marketisation and privatisation,

The coalition has refused point blank to stop profiteering, despite the PFI review recognising that windfall gains and excessive profits have occurred

are the coalition's main methods to drive the neoliberal transformation of public services and the welfare state. Unsurprisingly, then, the government's new Private Finance 2 (PF2) policy, announced with the autumn statement, is a rebranding of PFI. Equity investment in PF2 contracts will increase to 20-25 per cent in PF2 contracts compared with 10-15 per cent in current PFI contracts – meaning there is slightly less debt involved – with the public sector becoming a minority equity investor on the same terms as the private sector. This means that the public sector will receive some of the financial gains from the projects.

The coalition has refused point blank to stop profiteering, despite the PFI review recognising that windfall gains and excessive profits have occurred. The private sector will not be required to share profits on the sale of equity in more than 700 existing PFI projects.

Much has been made of the public sector being able to take a minority equity stake in future PF2 projects, but the benefits are far from straightforward. For starters, PF2 introduces new conflicts in the role of the state, between client and contractor roles, and between financial and community interests. Who will hold dodgy projects to account when the

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