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Alex Alexandrou

Police Federation of England and Wales

Peter Moran

University of Bolton, P.Moran@bolton.ac.uk

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The Private Finance Initiative: Mortgaging Away The Police Service?

Alex Alexandrou* and Peter Moran.**

* Research Officer, Police Federation of England & Wales.
15-17 Langley Street, Surbiton, KT6 6PL, UK.

** Senior Lecturer, Bolton Business School, Deane Rd,
Bolton, BL3 5AB, UK.

Introduction.

Throughout the 1980s, the UK government acted to remove impediments which prevented private sector involvement in what had been until then, regarded traditionally as the realms of the public sector. It sought the utilisation of private sector finance and "expertise" in improving the enterprise and efficiency of the public sector. Privatisation is the most complete way to secure this, however, where the public sector retains the role of service provider, the government has examined other ways of securing private sector input. Through this process the Private Finance Initiative (PFI) became a reality.

In particular, the government was keen to introduce private finance to the capital expenditure elements of service provision, where this could be established as more cost-effective. A plethora of projects were identified that could utilise private finance in such areas as; public health, law and order, transport, etc. The form of re-payment to the private financiers of these projects varied, from levying direct charges on the public, i.e. toll bridges, to acquiring/constructing a capital asset which would be available to public sector service providers in return for a consideration from the public purse on a long -term basis.

The underpinning logic was that the public sector would be relieved of an obligation to undertake capital expenditure in the short term, in return for higher re-payments or lower receipts later, i.e. a form of "borrowing" in the widest sense. The government was also willing to explore cases where the private contractor could provide a service in which the financing of a capital asset formed a significant portion of the deal. Private financing of public services was regarded as interposed between the boundaries of public and private provision with the salient criteria being cost effectiveness, based on comparing public and private investment options on standard investment appraisal techniques, which would take account of differences in financing costs, the transference to the private sector of the risks connected with project overruns and/or a failure to secure the benefits of investment. Hence, a strong incentive for improved efficiency on behalf of private sector investors could be achieved. The risk of losses, unprotected by public sector guarantees was at the head of market disciplines, and the provision of extra incentives for the private contractor was held to be the key.

Borrowing by the private sector to engage in PFI activities would have the same economic effects as borrowing by the state to finance public expenditure in the conventional fashion. The government's objective was and remains, to reduce the proportion of national income absorbed by the Public Sector Borrowing Requirement (PSBR) and in particular, it wanted to guard against private finance being used to finance public sector activity by the "backdoor".

From these roots, the PFI was launched when Norman Lamont, then Chancellor of the Exchequer made his Autumn Statement on 12 November 1992, in which he said; "In the past the Government have been prepared to give the go-ahead to private projects only after comparing them with a similar project in the public sector. This has been applied whether or not there was any prospect of the project ever being carried out in the public sector. I have decided to scrap this rule. In future, any privately financed project which can be operated profitably will be allowed to proceed...the Government have too often in the past treated proposed projects as either wholly private or wholly public. In future, the Government will actively encourage joint ventures with the private sector, where these involve a sensible transfer of risk to the private sector...we will allow greater use of leasing where it offers good value for money. As long as it can be shown that the risk stays with the private sector, public organisations will be able to enter into operating lease agreements, with only the lease payments counting as expenditure and without their capital budget being cut" (Hansard, 1992).

Since this first announcement, Kenneth Clarke, the present Chancellor has clarified its status and set out guidelines which apply to all projects in the public sector which require Treasury approval. These are;

- The possibility of private finance should be addressed explicitly when plans are being drawn up.
- The initial test for involving private finance must rest on whether it is, in principle, possible to transfer control and associated risks to the private sector without disproportionate costs.
- The final decision for involving private finance should rest on value for money considerations.

To assist PFI, the Private Finance Panel has been created to encourage greater participation by the private sector. The panel along with government departments identified in excess of 1,000 potential PFI projects with a capital value of £25 billion, with the present value of payments throughout the projects' lives of between £40-60 billion (H.M. Treasury, 1995;11)

Problems With Pfi.

Despite the laudable sentiments expressed in favour of PFI, connected with increasing value for money for taxpayers, transferring risk to private players in the market and improving the efficiency of management, there are considerable drawbacks associated with this strategy for service provision. A raft of potential problems has been drawn up and investigated by the Treasury Select Committee (1996), although the principal concern was to establish whether the PFI was intended to supplement or replace public

capital spending, other issues included;

- Does it provide better value for taxpayers?
- What would happen in the event that a private contractor went bankrupt and was unable to fulfil the contract?
- How can Parliament and the public be kept informed of developments without weakening the power of the Government to obtain the best deal?
- What clarification should take place of the rules governing PFI and the application of commercial confidentiality?
- Which types of project do and do not qualify under the PFI and where is the bifurcation between the two?
- Which approach is adopted to risk transfer?
- What are the revenue consequences of PFI?

The Treasury Committee's Report (1996; p.v, par 4) stated that; "... it has become increasingly apparent that the sums of money projected under the PFI are in practice replacing orthodox public capital spending and allowing cuts in expenditure to be made".

The transport budget was held up as an example, falling from almost £6 Billion in 1994/5 to £4.18 Billion in 1996/7 which are matched by projected rises in capital spending under PFI to £1.12 Billion in 1996/7. Witnesses before the Committee stressed that through achieving increased value for money, the PFI had, in fact, led to an ability to increase expenditure in other areas, i.e. the PFI has become a double edged implement; although substitutional in that it allows orthodox expenditure to be reduced, is also additional in that it effectively permits additional spending.

The Treasury Committee's view is that "... the PFI is now being treated by the Government as substitutional. It is enabling the Government to cut capital budgets in future plans ...It is arguable that the PFI hands over a considerable number of capital projects to bodies whose main concern is the profitability of the facility. If the need for a facility, and its probable profitability do not coincide, the Government will need to take steps to ensure that services continue to be planned and provided. It would be unacceptable if the Government's planning for the future provision of roads or hospitals began to be driven by the shorter-term perspective of private bidders" (Treasury Committee, 1996; p.VI par 7).

The committee asked the Treasury for its views as to whether the privatisation of projects should be the responsibility of Government and Parliament, or those seeking to provide projects on a commercial basis? The Government's response was straight forward; "... The Treasury firmly believes that project prioritisation must be a matter for the purchaser.... projects are, therefore, prioritised in terms of how they fit within the framework of departmental objectives, rather than their attractiveness to the market. The Government believes that in cases of services that include a capital component, PFI will usually emerge as the procurement route of choice since it reaps the efficiencies inherent in harnessing private sector management expertise to its finance, in a payment structure dependent on results" (Treasury Committee, 1996a, p.IV).

The Treasury Select Committee believe that PFI is a mechanism by which capital spending is converted into revenue expenditure, which may increase the extent of the legal commitment to revenue expenditure even when the need for the facility funded in this way may have long ceased to exist. In particular, the committee raised three related concerns.

First, the development of the PFI brings with it the potential loss of control over public spending which will result from the revenue expenditure implications of PFI commitments entered into by a diversity of organisations. The committee acknowledged that part of the difficulty of monitoring the level of future commitments is linked to PFI contracts being negotiated by bodies removed from the Treasury, and, in some cases, the government department responsible. The Treasury advised the Committee that there were no systems in place to monitor forward commitments in a systemised way of any sort.

Second, by turning capital into current spend, the PFI will partially undermine the need for the introduction of resource accounting, as the public sector will own fewer capital items to which it can apply accruals accounting techniques. This reflects a broader policy concern, that the introduction of PFI might impinge upon departmental abilities to strategically plan their capital investment programmes. Anxieties related to project suitability and bidding costs are sharpening the focus of the private sector on which schemes they bid for and invest in. The possibility arises that those projects with identifiable revenue streams may attract PFI bids and proceed whilst those less attractive by this narrow criterion may be delayed despite their departmental significance. The spectre then arises that funding mechanisms rather than coherent strategy or an evaluation of desirability may act to determine which capital assets are delivered.

Third, large PFI spending programmes may not show as capital outflows, but which will post increasingly large bills to future public expenditure. It is in this crucial sense, that the use and abuse of the PFI is capable of transposing capital into revenue spending, the costs of which are to be met in the future and, therefore, can be regarded as "mortgaging away the future" of part of the public sector.

In response, the Government tasked the Treasury to monitor commitments to safeguard against an imprudent build up of future liabilities which might impair a future Government's ability to change spending priorities, reduce expenditure in a given area or to deliver relevant services by other means. Additionally, there will; be a "control mechanism" to ensure that PFI payments do not extend beyond the point at which individual departments would lack the scope for other contingent priorities, including investment which did not lend itself to PFI.

The Government also stated that capital projects should not be examined where it would be considered "patently absurd or unrealistic" (Treasury Committee, 1996a;ppVI-VII). By means of explanation it suggested that in some circumstances the PFI procurement route would be inappropriate where:

- There is an overriding operational need for complete public sector ownership and control e.g. defence missile systems.
- There is no prospect of transferring significant control of risk to the private sector without disproportionate cost e.g. minor building maintenance.
- The costs of transferring a significant proportion of the costs associated with the project outweigh the expected benefits.
- Projects already in the pipeline or further phases of existing contracts which have been procured under the traditional methods.

Furthermore, Treasury guidelines make it clear that before proceeding to procurement, departments' outline business case should address whether the project should go ahead at all and, for low value projects in particular, whether PFI could be expected to deliver value for money. The Committee also raised the difficulties associated with the optimum allocation of risk to maximise cost effective solutions. Some evidence presented to the Committee inferred that this optimum transfer of risk had not always been achieved to the detriment of value for money. This has implications for individual projects (representing less than best value) and the policy as a whole (as firms raise their bids for other projects to compensate for their total risk).

Indications by the Comptroller and Auditor General that the National Audit Office plan to examine PFI's value for money will hinge on a study of the negotiations conducted by individual departments, effective working of contracts, risk transfer and effective open competition in ensuring value for money.

PFI In The Police Service.

Until recently, the police service had been virtually unaffected by PFI, however, in September 1995, the Home Office (1995) issued a briefing paper describing examples of opportunities which might be available to police forces and their respective authorities adopting PFI. The paper highlighted the extensive and variable "quality" of police buildings and estates and this would require further investment. The document stated the Home Office commitment to; "... a staged withdrawal from the major building programme, with the resources released being shared out by formula. Within a few years there will no longer be any prioritised central funding for individual projects. It will be for individual police authorities to plan and budget for all necessary building work from within their own cash-limited resources.

Authorities should look very carefully at the opportunities for making creative use of their existing estates effectively to lever private funding into new construction projects. Many police buildings occupy prime sites which are of considerable commercial value for re-development. Where replacement is required, it may be that a private company would be prepared to offer very advantageous terms in return for the opportunity to develop the existing site, with the new police facility being built elsewhere. The company would accept all the risk of realising the potential profit, but the savings for the police authority would be built into the transaction". (Home Office, 1995).

In addition to replacement facilities, the paper also highlighted the area of "shared use" where private finance could play a role. It accepted that there may be limitations in actually running a capital intensive facility, such as a vehicle workshop, or supporting and maintaining a capital based system, such as Information Technology (IT) or communications. The Home Office suggest that in such circumstances the private sector would accept the risk of consistently operating to agreed standards within a payment structure that offered value for money in comparison to publicly funded alternatives. The paper also proposed that there could be scope for the private sector to provide capital facilities to the police, on the understanding that they would be shared with other customers, the underpinning logic hinging upon the potential for the private provider to generate additional income from other clients thus permitting police users to negotiate advantageous terms.

The first police related PFI project in the UK concerns Derbyshire Constabulary's procurement of a new section station at Ilkeston. This is being monitored closely by other regional forces. In addition, 14 pathfinder projects have been announced which incorporate a spectrum of activities wide enough to permit essential lessons to be learnt and provide a basis for implementing PFI throughout the Service in England and Wales.

These Pathfinder projects include;

- Cheshire Police HQ and Training Centre.
- Cleveland Police Training Facility.
- Cumbria Police Training Facility.
- Dorset Police - Section Station at Dorchester.
- Greater Manchester Police - Force wide property review.
- Gwent Divisional Police Station at Ystrad Mynach.
- Hertfordshire Police Communication System.
- Norfolk Police HQ.
- Northumberland Police Mounted Section Facility.
- Nottinghamshire Police - Centre for Traffic Communications.
- Surrey Police Regional Dog Facility.
- Thames Valley Police - Area HQ at Abingdon.

Source; SFI (1996)

Pfi In The Policing Context.

We have outlined elsewhere the advancement of the private sector into areas once regarded as the sole domain of the police service (see Moran & Alexandrou, 1994, 1995). Without duplicating this earlier research, it is necessary to understand the policing context in which PFI is being introduced. Within the last few years, there has been an increasing emphasis on civilianisation within the service, combined with the contracting out of some functions e.g. court escorts to the private security industry. In addition, the Home Office have sought to raise significantly the number of volunteers (Special Constabulary). These developments have taken place against the backdrop, if not as a direct result of various inquiries; Sheehy (1993), Cassels (1996), Home Office (1995a) which have already absorbed considerable amounts of the time and energy of senior officers and other ranks.

The Audit Commission (1994,1996) also have inquired into various aspects of policing

and, in addition, the Home Office has relinquished its responsibility for setting the establishment (numerical strength) of police officers and changed the formula for police funding. The upshot has been a decrease in the number of attested police officers and tight cash constraints on Police Authorities. It is in this ambience of turbulence and uncertainty that PFI has been added to the policing agenda.

The most pressing issue for the police service is to bolster the patrol function and put "more bobbies on the beat". PFI may assist in permitting this objective to be achieved, at least in part, but there are a number of accompanying concerns. One way to increase the number of officers on the beat is to secure the requisite investment in appropriate IT systems, to relieve the burden of administration on existing officers and, in this fashion, permit more of their time to be utilised on patrols.

A report in Computer Weekly (1995) suggested that the police capital expenditure budget (which would include monies allocated for IT) had been reduced by 20%. Although this might be expected to increase the difficulties in freeing officers for patrol by investing in IT, Computer Weekly suggested that this may be overcome given that forces have sufficient flexibility to invest in IT via leasing deals or through the PFI.

Paradoxically, leasing costs would be deducted from force revenue budgets, decreasing the amount of cash available for officers' salaries (both for new entrants and serving officers) and if the cash came via PFI, this would represent substitution (to compensate for the 20% loss) of private for state funding and be interpreted as linking the amount of time available for patrolling from among existing officers to the amount of finance the private sector are willing to invest in the form of PFI.

Another way of making up the shortfall to either invest in IT and hence free existing officers, or to recruit additional police officers, would pivot on the re-development of existing police real estate. Whilst it remains true that some police facilities are in areas which might be expected to attract both substantial interest from the private sector and premium prices, others are not. An implicit assumption in this line of argument is that the private sector would be both able and willing to provide an improved police facility elsewhere (otherwise why would the police be expected to move? Perhaps they would move to a less adequate facility if the pressure on capital budgets is maintained indefinitely and this raises questions over the public interest in these matters) and still make a profit from the exercise (otherwise why would the private sector get involved?).

The imbalance of regional property prices might also skew the re/distribution of additional police patrols funded in this way. This might effect the profile of police patrols positively in regions where property prices are higher. Whatever the outcome, police real estate can only be disposed of once. The suitability of this strategy in the long term remains open to debate.

Where the police might share a capital intensive facility with other users, the ability to secure advantageous terms is suggested as the through route for greater efficiency in the provision of policing. The type of facility to be shared and the potential partners may need to be considered from the perspective of maintaining security as well as cost. If

the private sector motive is profit maximisation, then the end result may be precisely that, "advantageous terms" may be more imaginary than real.

Conclusions.

At the time of writing (January 1997) the search for improvements in policing has been continuing for some time. Despite the fanfare with which PFI has been launched, it is still too soon to come to any firm conclusions about the efficacy of PFI in the provision of the police service. Evidence and evaluation of the 14 pathfinder projects announced and any others that "come on stream" in the meantime is not yet available.

If PFI delivers additional benefits to the police service then it will be applauded. However, as we have outlined above, there are concerns about the precise mechanisms by which these will be delivered. The resources available to the Police have been tightly limited by the government for some time. The State has sought to improve efficiency by hiving off "non-core" activities to the private security industry, increasing the number of volunteer police officers and reducing the pay and other emoluments of probationer constables following Sheehy's Report (1993). In the light of these past approaches to resourcing an extremely important emergency service, we are not optimistic that PFI will bring any additional monies in its wake, it is more likely that PFI will be used as a device for further reducing the state funding available for policing.

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