

Private financing for public infrastructure is here to stay despite “PFIs” being consigned to history

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*George Osborne has recently outlined newthinking on private financing for major public service projects. Widely criticised as saddling public bodies with long-term debts, the Private Finance Initiative funding model has been used extensively since the 1990s. **Mark Hellowell** examines whether the Chancellor’s speech outlines a strategic shift or is more semantic.*



As **Norman Lamont** rose to deliver his autumn financial statement in November 1992, Britain’s economy and public finances were in a mess. Growth was negative, the deficit was clipping along at 8 per cent of national income and three million people languished on the dole. In his speech to the House of Commons, the Chancellor pointed to global events as the explanation for Britain’s economic frailty and outlined a bold plan for growth, the key to which was the “**liberalisation**” of the rules on private financing to allow new infrastructure projects to proceed without adding to the core measures of government indebtedness.

This was the start of the **private finance initiative** (PFI) under which £75 billion of private capital has been invested in British public infrastructure by successive governments, and through which current ministers are seeking to invest a further £7 billion. But that last chunk of capital will, it appears, be the last throw of the dice for this broadly discredited policy. Under proposals outlined by **George Osborne in a speech** made in similar economic circumstances to his Tory predecessor, private finance will henceforth come through a new delivery model.



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can lose money. *That requires lenders to carry out due diligence pre-contractually and many investors lack the necessary skills.*

One solution is to divide the financing, so that banks, with their market expertise and risk-bearing capacities, fund the project during the development phase and then exit the project once it reaches stable operations and can be refinanced into the capital markets. This would capture some of the benefits of bank involvement – such as the ability to filter out poorly structured projects – while reducing the cost of capital. In fact, this model is currently being considered by the [Scottish government](#) as a further evolution of the Non-Profit Distributing Model – the version of the PFI used in Scotland since the Nationalists took power in 2007.

If, however, the government wants institutional investors to take on risk “from the word go”, this is likely to require some form of credit enhancement in the form of a government guarantee. The infrastructure plan says the government will consider using “transparent forms of guarantee” to support projects where this can lead to a cheaper deal. However, this approach has led to concern from some quarters, including the [Treasury Select Committee](#), perhaps the most incisive critic of private finance. In a report in mid-January, it noted: “There are risks associated with the methods proposed by the government which involve taking on further contingent liabilities or providing guarantees, which could crystallise into calls on public funds. The creation by the back door of new forms of financing which carried some of the defects of PFI would not be the right way forward.”

Right way or not, off-balance sheet financing has long been a motif of British chancellors under fiscal stress. The chancellor is facing increasing political pressure to show some interest in growth despite rigid fiscal rules that require the sharpest fiscal contraction since Sir Eric Geddes wielded his axe in the 1920s. A range of off-balance measures from credit easing to subsidies for house purchases imply that private finance for public infrastructure is here to stay – even if the PFI acronym is being consigned to history.

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