Darling's dilemma over PFI

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The best part of £30bn ($59bn) from existing private finance initiative deals is to come on to the government's balance sheet in April, leaving Alistair Darling, chancellor, with some tricky decisions over the Treasury's response in the Budget on March 12. With public sector net debt already perilously close to the government's self-imposed ceiling of 40 per cent of gross domestic product, the reclassification of PFI deals will put pressure on the chancellor either to rewrite his budgetary rules or to raise taxes. But experts in private- and public-sector accounting believe the introduction of international financial reporting standards (IFRS) to the public sector from 2008-09 will also bring big benefits. It will remove the perverse incentive for public bodies to accept PFI deals that are bad for taxpayers just to avoid the capital value appearing on the government's books. It will also make possible new forms of infrastructure financing, enabling government to pass construction risk to the private sector while raising much of the finance itself at cheaper rates. Professor David Heald of Aberdeen University, a member of the government's Financial Reporting Advisory Board, said the final decision on the treatment of PFI under IFRS would be taken at the end of the month, but "it looks as though most [PFI] things are going on the balance sheet". Ken Wild, a partner at Deloitte's, also a member of the FRAB and of the International Financial Reporting Interpretations Committee, added that, while "no one can yet claim to know the exact proportion, pretty much everyone now thinks that all of it, or pretty much all of it, will be coming back on". The precise implications for the government's fiscal rules will depend on the Office for National Statistics, which is considering its stance. If the ONS follows its past practice, public sector net debt would breach the 40 per cent of national income ceiling, probably by the end of the year. Prof Heald suggested the Treasury should raise its debt ceiling accordingly, as would happen with private sector contracts and covenants when accounting standards changed. The move will have a big impact in health and local government, where most PFI projects are currently off balance sheet. According to the Audit Commission, in the case of the National Health Service "reclassification of PFI assets will potentially have significant financial implications for individual organisations". If current rules were not amended, NHS trusts would have to pay not only the annual service charge for their PFI buildings, but also an annual capital charge on top. The Treasury and 4Ps, the body that advises local government on public-private partnerships, both insist PFI will continue at its planned level with £11bn of credits promised to local authorities in the current spending round. But Mr Beaumont said: "If government expenditure has to stay within the 40 per cent rule for investment, there are worries that non-PFI investment will be squeezed."