The pros and cons of PFI are more nuanced than Labour thinks

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THE financing of public infrastructure is hardly a topic to set pulses racing. So it is a measure of the unpopularity of the private-finance initiative that a Brighton conference hall erupted when John McDonnell, the shadow chancellor, promised there would be no new PFI deals under a Labour government and that he would bring existing ones "back in-house". Horror stories about rip-offs under PFI contracts--including one in which a school had to pay [pounds sterling]487 ($650) for a lock--go some way to explaining their bad reputation. That the beneficiaries of this largesse are companies making, in the words of Mr McDonnell, "huge profits", explains the rest.

The shadow chancellor's statement marks a break with a previous generation of Labour wonkery. Although PFI was introduced by the Conservatives in 1992, it blossomed under the subsequent Labour government. Centre-left technocrats believed that bringing in private investors to design, build, finance and operate schools, hospitals and the like, with the state promising to lease the asset for decades, would have two main advantages. First, by giving contractors an incentive to consider maintenance, and by increasing private-sector involvement in management, it would make construction cheaper and of higher quality. Second, by keeping infrastructure investment off the public balance-sheet, it helped Gordon Brown, the chancellor from 1997 to 2007, to meet his rule that public debt should not exceed 40% of national income.

Countries around the world have copied the approach. But its use in Britain declined significantly after the financial crisis of 2008 (see chart). Public debt rose, investor enthusiasm declined and accounting rules were tightened to bring more of the debt onto the public balance-sheet. Popular discontent with contracts that offered little flexibility contributed to their falling out of favour. In one recent example, Sheffield council may have to compensate a public-maintenance contractor after protests stopped the firm from felling trees.

According to a Treasury estimate last year, PFI and its successor scheme have financed 716 projects with a capital value of [pounds sterling]59bn. Much like public financing, the overall record of PFI is a "mixed bag", says David Heald of the University of Glasgow. The National Audit Office, an official spending watchdog, looked at a sample of such projects and found that two-thirds were built close to the specified time and budget. Although some of the early contracts offered extremely high returns to investors, partly because of a lack of experience in the Treasury, later ones were more sensibly drafted.

Nevertheless, some of the initial advantages of PFI--such as lifetime responsibility for contractors and specifications that encourage innovation--can now be achieved with conventional forms of contracting, notes one former Treasury official. Using public funding to employ contractors directly has the additional benefit of requiring less civil service expertise, which has eroded since the late 2000s. The government has updated PFI rules (creating "PF2"), with the aim of making contracts more flexible, shortening the tendering process and ensuring greater transparency about the costs of finance, something which was previously lacking.

Such changes may alter the calculation about whether to use PFI in a given case. But the overriding assessment should still come down to whether better private-sector management will be sufficient to make up for the higher cost of borrowing, says Professor Heald. Mr McDonnell's promise to rule out the use of PFI in any circumstance would deprive the government of a financing method that will, in some cases, be the best option. And although it may be sensible to review contracts, bringing large numbers of them back "in house" could reward firms in instances where contracts are to the advantage of the public sector. It may also mean the taxpayer showering private firms with even more money, in order to honour break clauses in the contracts. That is not, presumably, something Labour conference-goers would cheer.