The art of concealment; PFInancing

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A parliamentary committee calls for the government to own up to what it owes

ACCOUNTING ruses to flatter balance- sheets are a bad idea, as Enron and Lehman have shown. Disquietingly, something similar has been going on in Britain's public sector through the Private Finance Initiative (PFI). There has been no full-scale parliamentary examination of the PFI for ten years. And it has taken a House of Lords committee to press for reform.

Before the PFI was invented in the 1990s, public investment in new hospitals and the like was financed upfront through government borrowing or taxation. Once a project was completed the public body met the bills for upkeep. The PFI turns this approach on its head. Private consortia finance projects which they build and maintain. Taxpayers repay the cost of the investment along with subsequent services over the lifetime of the deals, typically 25 years.

Although the PFI started under the Conservative government of the early 1990s, it has flowered under Labour. The capital value of PFI projects had risen by 2009 to [pounds sterling]64 billion, close to 5% of GDP. This includes the controversial "public-private partnerships" to renovate London's Underground (one of which collapsed, leaving the taxpayer to foot the bill). Excluding these (and PFI deals signed but not yet delivered), the capital value of operational projects is [pounds sterling]34 billion.

There is a good reason for the PFI, but also a bad one. The good reason is value for money. Conventional procurement has too often been a litany of overruns and delays, and it does not create an incentive for contractors to consider maintenance costs. If the PFI brings in construction on budget and time, and upkeep is cheaper, then it is likely to offer value for money, even though the private sector cannot borrow as cheaply as the government can.

The bad reason is that the PFI is a way of massaging public-debt figures. The unstated practice for some parts of the public sector, such as National Health Service hospitals, is that PFI is preferred to other sorts of investment funding because it is kept off the public balance-sheet.

Evidence from the National Audit Office, Parliament's spending watchdog, makes this abundantly clear. Of the [pounds sterling]28 billion capital value of operational PFI projects in England (excluding the Tube), 78% is not recorded on the public balance-sheet. This feeds through to keenly watched fiscal figures for government debt, since these include (with some wrinkles) PFI liabilities only when auditors have already specifically assigned them to the public sector.

A change in public-sector accounting standards should have changed this from April 2009. But the Treasury has insisted that public bodies keep a second set of accounts, thus keeping most PFI debt out of sight. The Lords committee on economic affairs wants all liabilities arising from PFI projects to be disclosed. Lord Vallance, its chairman, says this would alleviate suspicions that the deals "are favoured because they misrepresent and underestimate the level of public sector indebtedness".

This reform is long overdue. As David Heald of Aberdeen University says, "the whole argument about value for money has been distorted because people have known that the accounting has been dubious." The sums involved do not appear that big, given new, supersized public deficits and debt. Yet by adopting this accounting wheeze, the government has raised doubts about its fiscal probity--doubts it can ill afford now it is so much in hock.