

This may be why all PFI bids must be in by 31st March...

Coming back to haunt him: the billions in debt that Brown thought he'd buried

PFI took £32.5bn off the books and helped the Government meet self-imposed rules on investment. It won't be so easy in future, says Magnus Lloyd

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The Government's reputation for prudence has been battered and pummelled by economic blow after economic blow ever since Gordon Brown left No 11. But it is a fiddle from his past as Chancellor that might yet deliver the knockout punch.

Next month the Treasury will be forced to overturn the great accounting scam that Mr Brown himself championed. The Prime Minister's fiercest critics argue that he has hidden more than £30bn of debt, which future generations will then be burdened with paying off.

On 1 April the Government will adopt international accounting standards, and departments will have to change the way they account for the Private Finance Initiative (PFI). This partnership between the public and private sectors has been the driving force behind the Labour Government's huge capital expenditure programme, but is hated by many as a form of privatisation by stealth.

The big attraction of the PFI has been to get spending off the Government's balance sheet. The capital value of the 621 contracts signed under the initiative is £56.9bn, yet only 42.4 per cent of this debt has made it on to the Government's books. The £32.5bn that has not been accounted for represents a staggering 541 projects.

The reason so few projects make up such a relatively large proportion of the overall capital value is that the three London Underground contracts, which include the now-defunct Metronet consortium, skew the data. They are worth a combined £17.6bn; if they were excluded, more than 80 per cent of the capital would be kept off the books.

What this has meant is that the Government has been able to spend big without threatening to break the rather arbitrary "rule" of sustainable investment that Mr Brown imposed on himself in his early days as Chancellor: that government debt should not be more than 40 per cent of gross domestic product.

In itself, all this is not proof of a scam. Some projects have such significant risk and control transferred to the private sector that those companies, rather than the Government, should indeed account for the project.

However, the Government has often gone to extraordinary lengths to ensure that it has transferred the risk. For example, AirTanker, the consortium set up to run the Government's £13bn mid-air refuelling programme, has been given ownership of the 14 aircraft in the scheme. This means that its shareholders, which include EADS and

Rolls-Royce, will keep assets paid for by taxation when the 27-year contract ends. During that contract, AirTanker will also be free to hire out those assets for commercial gain. Yet insiders say the consortium itself never demanded sweeteners.

In the late Nineties, the Treasury decided to adopt a different PFI accounting method to the private sector. Most PFI experts agree that the Government's method was far more sensitive to changes in variables, meaning it could easily be manipulated to show that the public sector bore the minority of a project's risk. Through the use of these separate methods, many projects have ended up on neither party's balance sheet.

The Financial Reporting Advisory Board (Frab), which guides the Chancellor on accounting issues, has long thought the situation to be ridiculous. As part of the Government's agreement to adopt international accounting standards, the Treasury has conceded that it must improve its treatment of the PFI.

In the next few weeks the Treasury, the Office for National Statistics (ONS) and Frab will agree to a new PFI accounting guideline, making it more difficult for departments to use the PFI simply as a driver to get those hospitals and schools off their books.

Most pundits have assumed that this will automatically mean that most or even all of the £56.9bn will be treated as on-balance sheet. But many projects would undoubtedly remain on the private sector's books as it bears the brunt of the risk – a Ministry of Defence source confirms that AirTanker would never end up on its budget – and there is no guarantee that the Government will reassess the schemes that are already built and operational.

The ONS wants all schemes to be revisited; the Treasury has fought a rearguard action, pointing out that this could cost millions in consultants' fees and might take three years to complete. Surprisingly, even leading accountants tend to agree with the Treasury, as they would sooner see the Government introduce the guidelines than end up delaying them because of trench warfare over past projects.

Nevertheless, Sir John Kingman, the Treasury's second top official, stressed to the Public Accounts Committee this month that the extent of the accounting change will essentially be a decision for the ONS. But a senior ONS source says the body will need the support of the Treasury and Frab to implement its conclusions.

At the select committee hearing, Sir John added that he had made clear to departments that they "should progress [PFI] projects that are currently in the pipeline", rather than concern themselves with the budgetary impact of a balance sheet change.

At least one member of Frab believes that several departments are woefully underprepared for any change, let alone one that has not been finalised only weeks ahead of the start of the 2008-09 fiscal year. Indeed, one senior official at a major spending department moans that he is starting to doubt that the international accounting standards will be adopted at all, so little has he heard from the Treasury.

To all of this, a spokesman for the Treasury says: "It is too early to speculate on the impact this might have on departmental accounts or fiscal aggregates."

He is correct. But it is not speculation to say that, from April, the PFI will be harder to manipulate simply so that Mr Brown does not break a rule – an obsession – that was really rather silly in the first place.