How do you shift risk to the private sector to justify private finance of public services?

There are various risks which the private sector can take on where they might be better at managing them in a way which improves results and lowers costs. When designing a tender and negotiating with a provider the public sector needs to be careful to avoid the position where the private sector privatises the gains but keeps the public sector on risk for the losses.

The clearest way to put the private sector on risk is to make it responsible for both the financing and the revenue. The M6 toll road north of Birmingham not only meant the private sector took all the risks of the construction, but also had to rely on the toll revenue to remunerate the capital. It had to compete with a free road provided by the state. In such a clear cut case there is no doubt the private sector is on risk.

Many PFI projects remunerate the private sector with a flow of money from the government or Council. Whilst the private contractor still has to "earn" the money by providing the school and equipment or carrying out various medical services, the money comes from the state and the state has to make sure the provision continues whatever happens. This weakens the amount of risk which is effectively transferred. In some cases the state provides shadow tolls or revenues based on usage, in other cases public money is paid year by year for use of facilities which the private sector paid for up front.

When the main point of a PFI is to provide a new school or hospital building for the state to use there can still be a proper transfer of risk. The risk mainly transferred is the risk of design, construction and fitting out. The contract to make annual payments for the facilities once provided can be designed around the budget cost of the project rather than the actual outturn, leaving the private sector at risk of budget and time overruns on the building.