

**Q. 6 - Explain what you understand by the Private Finance Initiative.
Evaluate how successful it has been in the case of the Skye Road Bridge,
using cost-benefit analysis.**

It's a dream – going to work, on a train that you know will be there on time, taking a trip to the A&E at your local hospital knowing that you won't have to wait for more than 4 hours until you are seen. Waiting one year for an operation, a waiting list on the NHS of one million (UK pop is approximately 60m as at June 2002). Does this seem far-fetched? Ludicrous?

Well it does exist – just not in the UK.

The UK is one of the richest countries in the world, especially with the current decline in the global economy. We are one of very few that is managing to keep our heads above water. So why can't our government deliver these public services that have been promised, in this and more or less every election speech we have had.

The Chancellor has pledged hundred of billions of pounds to build the public sector: £180bn into transport alone, and we are all too aware of the disaster of our railway network.

I work in the public sector – for the local government, and I know why Tony Blair admires entrepreneurs like Richard Branson so much – he gets it done!

Our office has been waiting for a scanner system to upload our documents for two years. If this were the Virgin Offices they wouldn't wait more than 2-3 months before getting another supplier.

Mr Blair and the Tory before him started to think that maybe the answer was not only private funding, but their thinking too. They needed the money because throwing (public) money at the situation was not helping. Yes, money was needed, but could they really afford to raise taxes? Well it is common knowledge that voters don't like a tax hike. So politicians looked elsewhere to fund these projects.

It was the Conservatives that looked at the idea of involving the private sector in improving the public services. They introduced Compulsory Competitive Tendering – CCT – obliging public bodies to offer contracts to the lowest bidder. The problem soon became clear that although a service might be cheap, but it could also be bad.

In 1993, the Tories pioneered the Private Finance Initiative (PFI) scheme. This involved cash raised by the private sector to build new public infrastructure. Not only did they bring in cash, but for ambiguous Treasury reasons, the cash didn't count against public borrowing, so it seemed as though public expenditure stayed low.

Under this scheme, the private consortium is responsible for the designing, financing, building and operating public projects in a contract that typically last for 30 years. The private consortium will be paid regularly from public money depending on its performance throughout the contract, leading to opposing politicians saying that the government are "mortgaging the nation's future". At the end of the period the project can be passed to the public sector. The government says PFI provides a way of upgrading Britain's old infrastructure on a large scale without increasing the burden of public debt. A major attraction is also avoiding making one-off large payments. PFI also gets round tough public rules that prevent public bodies raising private cash.

The attraction for the private sector is similar to that of a bank, (or building society) providing a mortgage to a homebuyer. They get regular payments for an extended period. Critics point out the interest rates and the repayments are costing more for the public. A survey of 200 members of the ACCA found that only

1% strongly agreed that PFI provided value for money. About 25% of these members had worked on PFI projects.

Various projects are involved with the PFI scheme – housing, property, transport and street lighting, waste management (Onyx), individual scores, one police station. This shows that the range of public services that the government want to involve the private sector. Seems to contradict the comments Mr Blair has made to the unions that the public sector will never be privatised (!).

The Skye Bridge



The Skye Road Bridge was the first major PFI project and in its breathtakingly mocking budgeting (£12m that “we” contributed, although it was supposed to be a PFI project) and its contempt for the people who actually use it, symbolises and typifies everything that is wrong with letting money into what should be state enterprises. It opened on 17th Oct 1995. The project’s major funder, the Bank of America provided £23million and this huge outlay would inevitable mean charges for use on the bridge.

Tolls for the Skye Bridge

VEHICLE DESCRIPTION	TOLL CATEGORY	TOLL (Each Way)
Motorcycle	High Season	£ 2.90
	Low Season	£ 2.40
Car (& Transit Vans <5.5m)	High Season	£ 5.70
	Low Season	£ 4.70
LGV (<7.5 Tons Gross)	High & Low Season	£10.80
HGV 1 (2 or 3 Axles)	High & Low Season	£14.00
HGV 2 (4 Axles or more)	High & Low Season	£27.90
Local Bus Service	High & Low Season	£16.40
Midi Coach (Up to 22 passengers)	High Season	£23.70
	Low Season	£15.80
Coach (More than 22 passengers)	High Season	£41.20
	Low Season	£27.90
Car & Caravan (or Trailer >2.5m)	High Season	£11.40
	Low Season	£ 9.40

Source: www.skye-bridge.co.uk

At £5.70 for a one-way journey the toll is steep. This led to locals not paying the toll and getting fined. Since then the toll has been cut - a practise of price discrimination and discount books issued to regular users, which is a form of using bundle pricing.

VEHICLE DESCRIPTION	DISCOUNT RATES	BOOK OF DISCOUNT TICKETS
Motorcycle	£ 0.67	20 Tickets £13.40
Car (& Transit Vans <5.5m)	£ 1.34	20 Tickets £26.80
LGV (<7.5 Tons Gross)	£ 7.84	10 Tickets £78.40
HGV 1 (2 or 3 Axles)	£10.13	10 Tickets £101.30
HGV 2 (4 Axles or more)	£20.26	10 Tickets £202.60
Local Bus Service	£12.26	10 Tickets £122.60
Midi Coach (Up to 22 passengers)	N/A	10 x Single Journey Rate
Coach (More than 22 passengers)	N/A	10 x Single Journey Rate
Car & Caravan (or Trailer >2.5m)	£ 2.68	Purchase Car Tickets

Source; www.skye-bridge.co.uk

The ferry that used to run between Kyle and Kyleakin has now been removed so it is now the only all year round method of access to the Island from the mainland – which makes it a monopoly in that area. Does this mean that if it is only way to get to Skye that is a success?

Cost benefit analysis is a technique that attempts to evaluate the social costs and benefits of an economic decision. In this case, the decision is whether to have built the bridge or not and whether to have used the PFI scheme.

Cost benefit analysis is on the whole used by the public sector, because although both public and private projects produce externalities, private firms do not consider these, because unlike the government they do not have an obligation to the public to maximise social benefits. It is relatively easy to place a value on private costs and benefits; however, it is not so easy to place a value on the social benefit and costs. What would be the value on the extra pollution that cars using the Skye Bridge would produce and the loss of business for the ferry companies, which was the main form of getting to the Skye Island? There are positive externalities too – increases in tourism, easier links with main land (better financially for export orientated firms), time saved in travel.

But how we put a value on these externalities. How can one put a value to the hours saved in crossing? One example would be to estimate the money that would be generated by firms given the extra hours? How can we take into account the value of human health that would deteriorate (asthma sufferers) given the extra traffic on the Island? It is difficult to put a value in present time on the funds borrowed by the government as they have a lower interest rate than the Bank Of America (major funder of Skye Bridge) would. This is because government borrowing is seen as low risk and given low rates. Determining the interest rate of public funds is known as the Social Rate of Discount (SRD). How important is the social rate of discount? The discount rate for government projects has critical implications for national budgets, for regional development, for choices, for the environment and for the size of government. Too high an SRD can mean under-investment in social programs. Too low an SRD can mean over-investment. Thus, the choice of discount rates can have ramifications that transcend the mathematics.

Social Rate Of Discount = (% of funds diverted from private sector consumption) * (before-tax opportunity cost of private sector consumption (govnt. bond rate) + (% of funds diverted from private-sector investment) * (after-tax opportunity cost of private-sector investment / 1 – tax rate)

All cost-benefit analyses consist of five major elements:

- (1) Statement of objectives
- (2) Discussion of alternatives
- (3) Quantification of related costs and benefits
- (4) Selection of a criterion for acceptable project determination
- (5) Specification of an appropriate social discount rate

The story of the Skye Bridge is one with many twist and turns. The state-owned signed it's own death warrant in the early nineties, when it allowed the Skye crossing to develop delays of hours with the removal of one if its ferries for repair. Locals had to leave their cars on the island and travel by foot. The Scottish Office approached local politicians with a possible scenery destroying but quick solution to the apparent disconnection from the mainland: a toll bridge. Not the best option, but the only one. A publicly funded bridge was so far down the list of priorities that it might be 20 years before a toll-free bridge could be constructed. From this we can see that the objective is simply to solve the problems of getting across the river, and congestion and delays associated with the ferry service. How could the tourist-dependent economy of Skye cope with no tourists? It couldn't, hence the bridge was born.

As discussed above, financially the bridge is without doubt a success, being the only way to reach the island from the mainland or (visa versa). But we are also interested in the social benefits of the bridge.

The social present-value of an individual project indicates is a good indicator of which project to choose among a choice of several alternatives. The aim of the SNVP is to maximise the marginal social benefits, which is an obligation that any government has to its public. It enables the decision makers to rank-order the alternatives and select the option so that marginal social benefits are maximised per (sterling) pound of marginal social cost.

The SNVP can be calculated as follows:

$$\text{SNVP} = \text{Present value of Marginal Social Benefits} - \text{Present value of Marginal Social Costs}$$

Whenever SNVP is less than zero, it is unwise to proceed with that particular project. Conversely, if SNVP is greater than 0, it does not mean that you should automatically select the option, but take part in further investigations of the validity of that project.

Our discussion of alternatives is already at a dead-end before we can think about it because for one, the bridge is already completed and two, as the Scottish Office accepted, it was the only option for the survival of the economy on the island.

As briefly described before, we shall now be discussing costs and benefits of this Skye Bridge project in more depth.

Costs for this project can be summarized as below:

Payments to Skye Bridge Limited

	£ (Millions)
Toll payments by users to be received by Skye Bridge Limited over the lifetime of the concession, together with 24 payments agreed in December 1997 by the Department to subsidise tolls for regular users	
Payments by the Department to or on behalf of Skye Bridge Limited for constructing the approach roads, and 12 compensation for the cost of design changes and delay following a public inquiry	
Other direct project expenditure by the Department	39
Including advisers' fees, survey work, land purchase and staff costs	
Total payments by users and the Department	39
Indirect public expenditure reflecting loss of ferry revenue by Caledonian MacBrayne	£1 million a year

As we can see, the direct payments by the public and the private consortium involved amounted to £39 million. Note that public funds have provided £12million and yet when they have to use the bridge, they are charged a toll that is by far and away the most expensive in Europe.

To work out a value, we need to add all the benefits and subtract the costs. The difficulty surrounding this was discussed above.

We shall first discuss the benefits of the increase in tourism to the ease of the travel across to the Island from the mainland.

Hotel Room Occupancy, %

	Skye and Lochalsh
Annual Average	
1996	56
1997	49
1998	53
July only	
1996	86
1997	76
1998	82

Effect of Tolls on Tourists Decision to Visit Skye

	Was Toll a Factor in Decision to Visit Skye?		Would Toll Discourage a Visit to Skye in Future?	
	No.	%	No.	%
Yes	41	10	56	13
No	370	89	328	79
Don't Know/Not Stated	5	1	32	8
Total	416	100	416	100

Source: System Three Tourist Survey

Estimated Number of Tourists by Route

	Skye Bridge/Kyle - Kyleakin	
	1995	1998
No. of cars	217,680	234,180
% on holiday	65	72
Estimated tourists	141,492	168,610
Estimated non-tourists	76,188	65,570

Source: DTZ Pidea Consulting and PACEC Baseline Study

As we can see the percentage from 1997 to 1998 has increased, number of tourists has increased. This has led to an increase in money spent and the main of the Skye economy is increasing. However, with this increased tourism, increased traffic, increased pollution will lead to a poorer quality of life for locals. Due to the complexity of this externality, it is beyond our scope to put a value on this.

A cost, which will directly affect all residents, is house prices. From the below table we can see that the population in Skye has increased more than the Scotland average and more demand for housing will lead to higher house prices. Skye is already one of the poorer regions of the country so this cannot be welcome news for the locals.

Population, 1991 -95

	Skye & Lochalsh	Scotland
1991	11,740	5,107,000
1995	11,940	5,136,600
1997	12,060	5,122,500
% Change '91 - '97	+ 2.7	+ 0.3
% Change '91 - '95	+1.7	+ 0.6
% Change '95 - '97	+1.0	- 0.3

Source: Registrar General

Those businesses that rely on mainland links are likely to see revenues increase a lot quicker than other businesses. However, those companies in the exporting sector have no viewed the bridge as a positive. This was not expected but many attribute this to the growing unrest regarding the tolls of the bridge.

More than 200 people have been fined and arrested for not paying and this causes unrest in the local community. Their view is that the bridge is long over due and that they shouldn't have to pay for a service, especially not as much as they are being charged. They are winning their case and as the table of prices above shows that locals (frequent users) are paying 50% less than others.

From the above arguments for and against the involvement of the private sector, it seems that government has seemed to lose sight of the cost benefit analysis. Quite rightly so, they want the entrepreneurial spirit embedded in the public sector to get it done. They have, however, forgot one point; the whole of point of our taxes is to make our nation a better and easier place to live. Even the right to cross a bridge which is 60% public is not free to cross. Over the hill prices for one of the poorer regions is not creating a marginal social benefit. Business and morale is down in the North-west Scotland. What is even worse is that the collection of these tolls may be illegal. What then of the 496 people who have been prosecuted? What action will they be allowed to take for wrongful prosecution? It seems that the Scottish Government has been left with egg on their face on this particular case.

It does not mean to say that other PFI schemes will be as disastrous. Let's hope the government has learnt from its mistakes (Railtrack and Skye Bridge) and move on to provide a service for its voters.

In the government's defence, it will take a further 20-30 years when the first contracts have me complete before the real cost of PFI can be judged.

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Word count 2608