This article was downloaded by:[NEICON Consortium]
[NEICON Consortium]
On: 13 July 2007
Access Details: [subscription number 762905488]
Publisher: Routledge
Informa Ltd Registered in England and Wales Registered Number: 1072954
Registered office: Mortimer House, 37-41 Mortimer Street, London W1T 3JH, UK

Policy Studies
Publication details, including instructions for authors and subscription information:
http://www.informaworld.com/smpp/title~content=t713442426

Managing the Risks of Public-Private Partnerships in Scottish Local Government

John Hood; Neil McGarvey

Online Publication Date: 01 March 2002
To cite this Article: Hood, John and McGarvey, Neil , (2002) 'Managing the Risks of Public-Private Partnerships in Scottish Local Government', Policy Studies, 23:1, 21 - 35
To link to this article: DOI: 10.1080/0144287022000000064
URL: http://dx.doi.org/10.1080/0144287022000000064

PLEASE SCROLL DOWN FOR ARTICLE

Full terms and conditions of use: http://www.informaworld.com/terms-and-conditions-of-access.pdf

This article maybe used for research, teaching and private study purposes. Any substantial or systematic reproduction, re-distribution, re-selling, loan or sub-licensing, systematic supply or distribution in any form to anyone is expressly forbidden.

The publisher does not give any warranty express or implied or make any representation that the contents will be complete or accurate or up to date. The accuracy of any instructions, formulae and drug doses should be independently verified with primary sources. The publisher shall not be liable for any loss, actions, claims, proceedings, demand or costs or damages whatsoever or howsoever caused arising directly or indirectly in connection with or arising out of the use of this material.

© Taylor and Francis 2007

Policy Studies, Vol. 23, No 1, 2002

Managing the Risks of Public–Private Partnerships in Scottish Local Government

JOHN HOOD AND NEIL MCGARVEY

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

ABSTRACT *The involvement of the private sector in the financing and provision of public services has been placed at the core of the Labour government's second-term public sector reform agenda. PFI/PPP is a key policy instrument that is being used to transform public services. This article reviews the debates surrounding PFI/PPP before examining the implementation of the policy in Scottish local government. A key element of PFI/PPP is risk transfer. The research presented here suggests that scope exists for poor risk management decisions in Scottish local authorities. The degree of risk management involvement in the process to date is variable, and where it does exist its extent is frequently limited in scope. Local councils in Scotland appear ill-prepared to manage the risk transfer process inherent in PFI/PPP. Faced with commercial operators with substantial advantage over them in the arena of risk transfer negotiation, this increases the likelihood of PFI/PPP initiatives which offer poor value for money for Scottish local government.*

Introduction

After the 2001 general election victory Labour declared its commitment to extending the input of the private sector in providing public services. This will undoubtedly involve the creation of more public–private partnerships (PPPs). PPPs stem from the Private Finance Initiative (PFI) introduced into UK government in 1992. Pre-election in 1997, the Labour Party tended to be very critical of PFI; post-1997 the Labour government has tried to adjust the negative imagery of PFI by labelling many new initiatives conducted under the programme as public–private partnerships.

In Scotland, the Scottish Executive has a Private Finance Unit that provides support for both public and private sectors on PFI in Scotland (see www.scotland.gov.uk/pfi). PFI started slowly, but almost ten years after its initial launch is beginning to have a significant impact across the public sector in Scotland. The 2001 Labour election victory and Tony Blair's declaration that there will be 'no ideological barrier' to greater PPPs in the battle to reform key public services, is likely to give the policy further impetus.

This article focuses on the risk management of PFI/PPP in Scotland's 32 local authorities, where it is now the well-established procurement route for major capital investment projects. In Scottish local government the biggest schemes to date have been Glasgow's PPP which involves the refurbishment of all of Glasgow's 32 secondary schools. Falkirk, East Renfrewshire and Stirling are among the councils that have signed contracts under the PPP. Other major schemes in the Scottish public sector include the £307m 'missing link' M74 road

John Hood, Division of Risk, Glasgow Caledonian University, Glasgow, UK. Tel: +44 (0)141 331 3154; Fax: +44 (0)141 331 3229; E-mail: J.Hood@gcal.ac.uk
Neil McGarvey, Department of Government, University of Strathclyde, Glasgow, UK. Tel: +44 (0)141 548 4462; Fax: +44 (0)141 552 5677; E-mail: n.mcgarvey@strath.ac.uk

ISSN 0144-2872 print/1470-1006 online /02/010021–15 © 2002 Policy Studies Institute
DOI: 10.1080/0144287022000000064

project across the south side of Glasgow; Skye Bridge; and Bowhouse Prison in Kilmarnock. The total capital value of these projects listed in the Scottish Executive's Project List now exceeds £2.5bn (Scottish Parliament, 2001, p. 2). The scale of these projects means that PFI/PPP will remain a major political issue.

After outlining the rationale and politics of PFI/PPP in Scotland this article adopts a risk management perspective on the implementation of PFI. PFI is fundamentally about the transfer of the risk associated with major capital projects from the public to the private sector. Indeed, one of the key elements of central government approval of any PFI scheme is that of risk transfer (DETR, 1998a). We introduce new empirical evidence on how Scottish local authorities have managed this transfer of risk.

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

Why PFI/PPP?

According to the UK government, PFI gives local authorities access to new sources of capital investment and management skills for new or improved facilities and creates new opportunities for the private sector to combine construction, facilities management, finance and operating skills (www.local-regions.detr.gov.uk/pfi.index.htm). New Design Build Finance Operate (DBFO) schemes involve, in theory, the various responsibilities and risks relating to procurement and operation of a public sector capital asset being transferred to the private sector. This involves a change in focus in the public sector away from the procurement of assets to the purchase of services associated with those assets, the level of payment by the public sector being based on the performance of private sector operators against contractually agreed levels of service.

In the longer run, DBFO contracts will be seen as the public sector purchasing access to and use of service assets, rather than the procurement of a capital asset. At present most involve the latter. In theory, the contractor should take responsibility for investing in capital assets, financing that investment and managing the facilities for the local authority. The risk is associated with the commitment to supply the service over an extended period for a specified level of payment. The risk is transferred to the contractor. In theory no local authority should give undertakings or guarantees in respect of contractor obligations and liabilities. If it were to do so, it would simply retain the commercial risk that should be transferred.

PFI/PPP is shaping up as one of the key political battlegrounds in Scottish politics. Local councillors and officials have been highly critical 'off the record', arguing they have been presented with little choice by the government (Lindsay, 2000). From the Left, PFI/PPP is seen as the latest encroachment of big business into the public sector as it seeks ever more profit-creating opportunities (see www.scottishleftreview.com for a critical appraisal of PFI/PPP). The Scottish National Party has drafted an alternative plan based on the creation of Public Service Trusts. There remains opposition from both the Scottish Trade Union Congress (STUC) and the largest union in local government, Unison. It has taken the government to the European Court to protect the terms and conditions of its members affected by transferring to the private sector. A recent report commissioned by this union *Public Service, Private Finance* (Unison, 2001) argued that PFI schemes lacked accountability, cost councils too much money and that they should be used only as a last resort for capital projects.

Many see PFI/PPP as indicative of the cosy relationship the government has with big business. It is the large multinationals that are frequently the key beneficiaries of PFI schemes. For example, in Scotland, PFI training is provided by PricewaterhouseCoopers under a programme approved by the Treasury Taskforce. PFI/PPP schemes frequently have very high transactions costs. Public bodies have to pay large consultancy fees to legal, financial, management and other advisers. Another problem is that the complexity of many PFI/PPP schemes dims 'the searchlight of democracy' as many councillors and MSPs struggle to grapple with

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

the legal and contractual intricacies of partnership arrangements. Moreover, as these 'deals' frequently involve substantial capital sums and long-term commitment on the part of councils, they are effectively binding successive administrations into arrangements they may not wish to be part of. PFI/PPP institutionalizes the private sector in Scottish local government.

PFI/PPP helps the state to afford to engage in more capital investment than it would by following conventional procurement methods. It is akin to taking out a mortgage, with public bodies being forced to pay the true market rate for capital. Commercial companies provide the initial capital and in theory assume the risks associated with construction and maintenance in return for guaranteed leases that will allow them to cover costs and make a profit. Instead of building new offices, schools and IT facilities, local councils now lease them from commercial companies, thereby providing the provider of these 'asset-based services' with a secure flow of income. Under PFI the main risk transfer issue is how secure the income flow to the provider of these services will be. Criticizing PFI, Walker argues

> Put simply, PFI is a way of getting public buildings built or refurbished without recording capital spending in the national account. It was dreamt up by John Major as yet another wheeze for a public unwilling to face the true cost of the public services it says it wants. PFI is what poor people used to call the 'never-never': you get something bright and shiny now but end up paying a lot more that its present cost over the long run. (D. Walker, 1999, 'Malignant Growth', *Guardian*, 5 July, cited in Pyper, 2001, p. 469)

On the other hand, proponents of PFI argue that it allows the public sector to avoid significant capital expenditure that will push up the Public Sector Net Cash Requirement (PSNCR). PFI/PPP also enables the public sector to tap into private sector management expertise. It allows councils to focus on strategic priorities and leave operational management tasks such as facilities management to the private sector. This is in line with the New Public Management (NPM) philosophy that has underpinned many recent government policies. The government would argue that PFI allows them to plan and budget more effectively as long-term contracts pass significant ongoing maintenance costs to the private sector.

It is thus in tune with New Labour's modernization drive. Broadly speaking, this programme seeks to reform government so that it is more flexible, embraces new technology and works in partnership with the private sector to create more responsive public services. This initiative entails the

> . . . review [of] all central and local government department services and activities – by consulting widely with users, by benchmarking and by open competition – to identify the best suppliers in each case. The focus will be on end results and service standards, rather than simply on processes. The aim will be to secure the best quality and value for money for the taxpayer. (HM Government, 1999, p. 41)

Effective procurement – without any particular preference for either direct or commissioned services providers – lies at the heart of New Labour's approach to service provision. There is pragmatism over the choice between in-house provision, partnership or private/voluntary sector provision.

Managerially, modernization emphasizes a shift from a focus on inputs to a concern with outcomes – providing services is no longer a sufficient justification for state intervention, it must create added public value (Stoker, 1999, pp. 243–244). There is a more open-minded approach to service procurement, and no presumption that in-house provision is always the best option.

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

Policies such as Best Value, Community Planning and PPP are designed to broaden the focus of local councils and move them away from the traditional methods of service delivery (see DETR 1998a, b, c, d, 2000 for details of the government's approach to local councils). These policies encourage the development of a multi-institutional approach to local public service delivery (for a discussion of New Labour's attitude to local government see Blair, 1998). One of the few beneficial lessons of compulsory competitive tendering (CCT) was that many commercial companies are not particularly keen on working with local councils who are unwilling partners. Commercial companies tend to seek long-term partnerships characterized by trust, reciprocity and a collaborative environment of openness and honesty, this being far more likely to encourage innovation and improvement. The extent to which such an environment exists in Scottish councils at present is questionable. There remain many Labour councillors still sceptical of the benefits of involving commercial partners in council operations. As the latest Best Value Task Force (BVTF) report noted, 'there are still those who instinctively prefer or are more comfortable with direct delivery of services' (2000, para. 47). CCT did not break this culture; indeed, in some councils it reinforced an 'in-house' culture – many Scottish councils became skilled at deterring external bidders from entering the CCT bidding process.

While the BVTF acknowledges that 'CCT has brought benefits in terms of greater specification and a more business-like approach to local authorities' (para. 48) there remain many councillors sceptical of commercial operators. The BVTF has signalled its preference for a 'mixed economy' wherever possible (BVTF, 2000, para. 51). For 'mixed economy' read public–private partnership.

All governments inherit before they choose as far as public policy is concerned (Rose, 1990) and the Labour government's approach to PFI reflects this fact. The re-launch of PFI was important for the government as it sought to distance itself from the 18-year Conservative legacy. PFI has connotations of backdoor privatisation; the new emphasis on partnership and joint working is more in tune with New Labour's 'Third Way ideology'.

Broadly speaking, the Third Way is a less ideological and more pragmatic approach to issues of public service management and politics. As Wright notes

> *It is an argument about change and the need to respond to change.* Proponents of the Third Way emphasise the dramatic changes taking place in the world, such as globalisation and new technology, and argue that a dynamic and inventive kind of politics is required in response. (Wright, 2001, p. 137, original emphasis)

The old certainties of direct provision are rejected and the selection of policy choice is not driven by a fixed ideological position but by attempting to find the best way to achieve a desired end. Over-arching values still have a role to play but effective policy making according to Third Way ideology demands a pragmatic, evidence-driven approach.

At the UK national level, New Labour's vision for the local political system involves a positive embracing of external actors rather than a reluctant accommodation with them. The Third Way philosophy accepts the limits of state action and the considerable scope for contributions to solving societal problems from the voluntary and business sectors and individuals citizens. New Labour accepts the 'realities' of governing and its modernizing commitment stems from a view that fundamental societal changes demand a radical rethink about state provision and practice. Local councils are defined as community leaders rather than simply service providers. Their role is to develop a shared vision, building partnerships to achieve social outcomes and seeking to support others to achieve valued social and economic objectives. The challenge for elected government at the local level is to actively steer processes of co-ordination and collective action across public, private and voluntary boundaries using a wide range of tools (Stoker, 2000).

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

This reflects a pragmatic political philosophy. 'It is what works that matters' is the New Labour mantra. There is no going back to the traditional direct service provision model of local government. New structures of local governance exist which blur the traditional distinction between the public and private sectors with state and civil society merging seamlessly into one within many different policy and service delivery areas. PPPs build on the existence of such structures and move localities to new modes of public service delivery based on self-steering inter-organizational networks (Rhodes, 1997). It is in tune with 'Third Way' thinking which recognizes the limitations of government, acting alone, being capable of effecting societal change, and accepts the new realities of governance.

Governance has been used as a blanket term redefining the extent and form of public intervention and the use of markets and quasi-markets to deliver 'public' services (Rhodes, 1997). Governance emphasizes the increasing impact of the private and voluntary sectors on local public policy delivery. In the fields of housing and urban regeneration, policy frameworks have been adapted to make it almost impossible to work without involving commercial partners in some way. Governance is taken to represent a pragmatic response to wider political and economic pressures. At the same time the modernizing government programme has been defined as involving a recognition of these 'new realities' (Stoker, 1999, p. 241). These 'new realities', from the perspective of government, are probably best encapsulated in Osborne and Gaebler's (1993) oft-cited phrase concerning the need for less rowing (or less direct intervention by government) and more steering (or governance). Whereas previously it was a phrase used to encapsulate ideological preference for less government, governance is now much looser and more associated with a learned response to the 'realities' of governing in a complex rapidly changing environment.

The changing nature of governance raises important questions. Rhodes (1994) suggests that the changes have contributed to a 'hollowing out' of the state with a loss of capacity by the central administrative machinery to control and manage the public sector. New Public Management (NPM) ideas emphasizing devolved management and competition have diminished the centre's capacity to control. It has been suggested by some commentators that we are witnessing the movement from a bureaucratic command to a more regulatory mode of governance (Hoggett, 1996). In a similar line of analysis, Hood *et al.* (1999) chart the movement away from direct provision as coinciding with the creation of new regulatory instruments to oversee the new providers of services. These are necessary to answer the questions of accountability that these new structures of governance raise (McGarvey, 2001).

Across all services and at all levels (strategic, operational and street level) of the organization local authorities are declaring themselves to be in partnership. The re-branding of PFI reflects New Labour's partnership philosophy. It is the capital expenditure equivalent of Best Value. The Best Value concept is the over-arching policy under which a whole series of initiatives have been undertaken to increase the responsiveness of local councils. Best Value encourages experimentation, innovation and flexibility in how local councils organize and deliver services. In-house council service delivery bodies must demonstrate best value against other options of service delivery. Linked to this is the considerable encouragement being given to public–private partnership arrangements and the pooling of funding streams. The Scottish Executive and the Convention of Scottish Local Authorities (COSLA) are involved in a Joint Working Group to examine ways of securing better outcomes in terms of service delivery from existing budgets, with emphasis on targeting resources to priorities agreed with the Executive (rather than simply to specific services). Community Planning also encourages partnership arrangements and is designed to offer the chance for institutions involved in local governance to co-ordinate policies, activities and resources to achieve shared goals (see Community Planning Working Group, 1998). Partnership is the new buzz-word in local government.

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

PFI/PPP and Risk

A key element of these new public–private partnerships is the management of risk. One of the key elements of central government approval of any PFI scheme is that of risk transfer (DETR, 1998a). As made clear by the Private Finance Panel:

> There are two fundamental requirements for a PFI project:
>
> i) value for money must be demonstrated for any expenditure by the public sector
> ii) the private sector must genuinely assume risk.
>
> The significance of these two criteria differs depending on the type of the privately financed project. (1995, p. 12)

The underlying rationale behind risk transfer in PFI is that risk should be allocated to the party that is best placed to manage it at the least cost. Clearly, if the public sector wished to transfer all of the risks associated with a PFI project to the private sector, the costs involved would be prohibitive (Glaister, 1999). Furthermore, this would not, arguably, represent value for money (VFM), as some of the risks associated with the project will be more directly in the control of the public sector and, therefore, capable of management by them at a cost less than the risk premium payable to the private sector. The proposed transfer of risk in any PFI project is subject to external audit and, subsequently, ratification by central government (Ball *et al.*, 2000). On the surface, the principle behind risk transfer would appear to be fairly straightforward and is a practice commonly used in contracts between private sector companies. In PFI contracts, however, the situation relating to risk transfer has been one of 'clearly a continuing level of uncertainty' (Broadbent & McLaughlin, 1999, p. 106).

The House of Commons Treasury Select Committee (2000) inquiry into PFI emphasized that risk transfer must be clearly identified, so that government bodies can set out clearly the risks that are being transferred. Risk is now a commercial product that is identified, priced and responsibility legally attributed (Centre for Public Services, 2001).

There is a dispute in the literature as to the equity of risk transfer in PFI projects. Grout (1997) claims that the VFM tests, particularly in respect of risk transfer, are biased against the private sector. This bias is, in Grout's view, predicated on the incorrect valuation of risk in the contracting process. On balance, however, the majority of the literature would suggest (see Ball *et al.*, 2000; Broadbent & McLaughlin, 1999; Coleshill *et al.*, 1998; Gaffney & Pollock, 1997; Mayston, 1999; Unison, 1997; Van Ham & Koppenjan, 2000) that risk transfer is, at best, a very unclear and poorly understood concept and, at worst, weighted in favour of the private sector. Furthermore, many of the risks assumed under contract by the private sector are, ultimately, passed on by them either to service users (e.g. Skye Bridge road tolls) or to their insurers. Whilst, in theory, the public sector can pass on some of their risks, in practice they often have more difficulty in doing so.

In the context of PFI/PPP projects, what exactly is meant by risk? Many cultural theorists have argued over what 'risk' as a concept means, but, as suggested by Adams (1995, p. xi), 'cultural theory warns that everyone will never agree about risk'. Lupton (1999) outlines three theoretical perspectives that can be placed along an epistemological continuum on approaches to risk. She identifies these perspectives as 'cognitive science', 'sociocultural' and 'social constructionist'. As regards PFI contracts, the paradigm utilized is that of the cognitive science approach, based as it is on realistic attempts to categorize risk in terms of:

- What could go wrong?
- How often will this occur?
- How much will it cost?

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

Even this approach, however, has its limitations as its sole focus is on something going wrong (i.e. the negative aspects of risk). Clearly, PFI projects also include some positive risk aspects. The private sector will expect some form of profitable financial return and the public sector is relieved of the risk of, for example, having to dispose of an unwanted asset some time in the future. Any semantic debate as to the meaning of risk in a PFI project is rendered redundant, however, by the general acceptance by contractual partners (see Akintoye *et al.*, 1998; Ball *et al.*, 2000; Broadbent & McLaughlin, 1999; Henderson, 1999) that there are distinct and finite categories of risk that should be considered under PFI projects. These risks are normally categorized as:

- design;
- project finance;
- construction and operation, including maintenance;
- demand/variability of revenue;
- technology and obsolescence;
- regulation and legislation risks;
- residual value.

Arguably, however, this is a limited model of risk for a public sector project, and reflects the need to clarify risks purely for contractual and financial purposes. It is widely believed that a key rationale behind PFI was to reduce government borrowing. Therefore to ensure that projects were off the balance sheet, as regards capital budgets, it was necessary to have definitions of risk. In effect, this meagre model of risk is utilized to ensure that a framework exists for risk transfer (and consequently VFM) calculations to be made. As has been indicated above, without a demonstrable VFM element, PFI projects are not allowed to proceed. Pollock and Vickers (2000) claim, however, that the purported cost savings from risk transfer are highly questionable, and, indeed, insufficient data exist on risk transfer to make valid claims for PFI representing VFM. This unsatisfactory situation is exacerbated by the findings of Unison (2001, p. 24) that the whole concept of VFM, in business cases examined by them, was dependent on the valuation of risk transfer.

Using Lupton's category of cognitive science for approaches to risk may, therefore, be an inadequate model for PFI projects. These remain projects which have an inextricable link with the provision of public services and, therefore, have a social dimension beyond purely financial considerations. Commentators such as Beck (1992) and Giddens (1998) utilize much wider definitions of risk in the public sphere, which contain aspects relevant to PFI projects. The current approach to risk management in these projects does not, however, lend itself to the incorporation of such social risk factors, so, as a consequence, this more expansive model of risk cannot be operationalized into the PFI system. Working within the confines of this narrow approach to risk, how, therefore, can the public sector attempt to ensure that it is achieving optimum risk transfer?

Risk Management

Risk transfer is a key aspect of risk management. It is that part which concerns itself either with transferring the risk itself (i.e. passing full responsibility and control of an asset or activity to someone else), or retaining the responsibility of the asset or activity, but transferring the financial responsibility for something going wrong to someone else (e.g. insurance).

Waring and Glendon provide a useful definition of risk management, which is particularly germane to PFI projects in that it encompasses the positive, as well as the negative, aspects of risk:

> Risk management may be defined as a field of activity seeking to eliminate, reduce and generally control pure risks (such as from safety, fire, major hazards, security lapses, environmental hazards) and to enhance the benefits and avoid detriment from speculative risks (such as financial investment, marketing, human resources, IT strategy, commercial and business risks. (1998, p. 3)

Although there is a danger in over-simplifying the situation, generally the pure risks would be insurable, whereas insurance companies are less likely to provide cover for the speculative risks. This distinction is important in the context of our later discussion on the role of the local authority risk manager.

The types of private sector companies that band together to form the consortia which deliver PFI projects, frequently referred to as 'Special Purpose Vehicles' (SPVs), will invariably have sophisticated risk management systems. For example, banks will have a whole range of qualitative and quantitative risk management techniques appropriate to financial risk, and the large construction companies will be experienced in the management of construction project risks. Add to that the risk expertise of the legal advisers, facilities management companies and the various consultants who are involved in PFI projects, and a picture emerges of a formidable degree of risk management experience on the private sector side. Does a similar level of expertise reside in the public sector, or is there a substantial degree of knowledge and skill imbalance?

The 1990s saw a significant growth in public sector risk management (Hood & Kelly, 1999). There were many reasons for this growth; for example, risk-related issues arising from public inquiries such as King's Cross and Dunblane, the move to risk-based health and safety legislation, changes in the public sector insurance market, especially those related to local authorities and, finally, the fact that many aspects of risk management squared with the tenets of NPM. The growth in public sector risk management has continued, with an increase in empirical research into its operational aspects (see Dowlen, 1995; Harrow, 1997; Vincent, 1996). Hood and Kelly (1999), using a small sample of Scottish local authorities, identified areas of concern regarding the organizational and budgetary aspects, which if replicated across the UK would suggest a lack of co-ordination, co-operation and rigorous financial planning. Given the centrality of risk transfer to PFI, such a situation would serve to reinforce any notion of risk management imbalance between the private and public sectors.

In addition to the rise in academic interest in the topic, central and local government departments have been exposed to a plethora of guidance documents on various aspects of risk management. These include innovation (NAO, 2000), procurement (DTI, 2000), risk assessment (ILGRA, 2000), risk management in housing (EVH, 2001; Housing Corporation, 2001), as well as more general risk management guidance (Accounts Commission, 1999; DCMS, 2000).

Risk Management and Local Government

Amongst the many reasons for the development of risk management in local authorities, arguably one is dominant – the change in the local authority insurance market which occurred in the early 1990s. Although risk management as a specific function can be traced back to the 1950s, prior to 1992, if risk management in local authorities as a distinct management practice existed at all in local authorities, it did not exist to any great extent. Fone and Young identify the prime cause of this:

> The lag in adoption more likely was due to the particular characteristics of the insurance market formed to serve local authorities in the UK. (2000, p. 37)

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

This insurance market was dominated by Municipal Mutual Insurance (MMI), which until the late 1980s provided insurance cover for over 90 per cent of local authorities. As its mutual status implies, MMI was owned by its policyholders – primarily the local authorities – and was not answerable to a wider body of shareholders. As a consequence, the prime objective of MMI was providing the widest form of insurance cover at the lowest possible rates. Local authorities were, therefore, substantially protected from the commercial realities of the wider insurance market. A combination of increased numbers of claims, higher settlements for personal injury claims, and an ambitious, but ultimately flawed, diversification strategy took its toll on MMI. By 1992 the company was insolvent and was taken over by the Zurich Insurance Group. It is not appropriate in this paper to compare the attitudes of MMI and Zurich to local authority insurance business, but suffice to say Zurich took a much more hard-nosed and commercial approach.

It was the failure of MMI that led local authorities to the realization that they had no strategy for risk management. They had been cosseted by MMI and were now on a very steep learning curve. Simultaneous developments in legislation, public interest in risk, and central government guidance on the topic forced local authorities into a position where they had to quickly develop risk management strategies and practices. It is a moot point (Hood & Kelly, 1999) as to how successful they have been, but there is certainly a case for saying that they have come some way in a relatively short time. In general, however, they have developed broader risk management skills for those risks which they would have previously insured with MMI. As Fone and Young point out:

> Risk management is widely practised in the UK and can be described generally as a management function concerned principally with insurance-buying and the management of insurable risks. Because insurable risks intermingle with other general organisational risks, local authority risk managers report a diversifying brief, with many having involvement in planning, public relations, financial risk management, internal audit and health and safety. Nevertheless, 'insurable risk' management remains at the heart of local authority risk management practices. (2000, p. 64)

All aspects of insurance purchase and management have traditionally been a function of local authority finance departments. Consequently, the move towards a broader risk management strategy has tended to see what were previously 'Insurance Officers' being retrained, or in some cases simply re-named as 'Risk Managers'. As was indicated above, this insurance background is perfectly adequate for the management of 'pure' risks, but does it provide adequate underpinning to deal with 'speculative' risks, such as those which may arise in a PFI contract? Furthermore, does this continuing focus on insurable risks mean that the local authority risk manager has been marginalized in the PFI process?

In a study for the Royal Institute of Chartered Surveyors, Akintoye *et al.* (1999) investigated the experience of local authorities of the risk aspects of PFI projects. Using a range of methods, these researchers concluded:

> The overall conclusion that can be drawn from the investigation is that not enough is known within the local authority sphere about one of the fundamental requirements of PFI, i.e. risk assessment and evaluation; this obviously must have an impact on the extent to which value for money can be achieved. (1999, p. i)

Although Akintoye *et al.* surveyed and interviewed a number of local authority personnel, only one risk manager was included in their list of respondents.

In our view, further empirical study is justified to address several issues, i.e.:

- The extent of local authority risk managers' involvement in the PFI process, both prior to and subsequent to the decision being made to proceed.
- The nature of their involvement.
- Their view on their level of expertise to deal with the risk aspects of PFI.
- The use of external risk consultants in PFI projects.
- The views of risk managers on the necessity of involving these consultants.

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

These issues were explored by means of a questionnaire sent to all 32 Scottish local authorities. The questionnaire was addressed to the risk manager, or, if there was no such job title, whichever officer had responsibility for the risk management function. It is accepted that the involvement of the local authority risk manager may be restricted by the narrow approach to risk followed in PFI projects. Despite any reservations over the narrow approach, it has to be recognized, however, that it is the one which is likely to be followed for the foreseeable future, and it contains elements which would fall within the expertise and remit of private sector risk managers. The question to be addressed is whether it is likewise with local authority risk managers.

Survey Results

Twenty-three authorities responded, giving a response rate of 72 per cent. Of these, 18 (78 per cent) had formally considered PFI projects and two (9 per cent) had not. The remaining three (13 per cent) respondents did not know if their authority had considered a PFI project. These responses reinforce the notion that the vast majority of Scottish local authorities are at least considering PFI/PPP as a procurement route. Of the 18 authorities, 12 (67 per cent) proceeded with the project, four (22 per cent) did not, and in two (11 per cent) the final decision was not known (see Table 1). The projects which went ahead reflected a range of service activities such as (the approximate value of the contract is shown where known):

- Road building and maintenance (£55m).
- Waste management (£45m).
- Schools and leisure (£20m).
- Finance and administration.
- Education (£51m).

In those authorities that had considered PFI, somewhat surprisingly only eight (44 per cent) of these had involved the risk manager/management function in the decision-making process. Those authorities that did utilize the risk management function did so in a range of ways. Generally, the involvement was as part of a group, and responsibilities included:

- Preparation of the Public Sector Comparator (PSC).
- Risk allocation modelling.
- Due diligence.
- Feasibility studies.
- Risk assessment/evaluation.
- Preparation of an outline business case.
- Insurance advice.

This relatively low involvement at the decision-making stage may reflect the lack of co-ordination of risk management within some local authorities (Hood & Kelly, 1999), a lack of expertise (Ackintoye *et al.*, 1999) and/or the fact that in many authorities what is badged as risk management is, in fact, merely insurance management (Fone & Young, 2000). Although

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

Table 1. Risk managers' involvement in PFI/PPP in Scottish local government

Local authorities (no. = 23)	Yes	No	Don't Know
Formally considered PFI/PPP?	18 (78%)	2 (9%)	3 (13%)
If considered, did PFI/PPP go ahead?	12 (67%)	4 (22%)	2 (11%)
If considered, was the risk manager involved?	8 (44%)	10 (56%)	
Sufficient knowledge, training in PFI/PPP?	7 (50%)	7 (50%)	
Utilised risk management consultants?	9 (75%)	3 (25%)	

Based on a survey of all 32 local councils. Responses = 23.

the risk management function contributed in only the minority of authorities, this contribution was in a wide range of areas. This would imply that if the appropriate risk management skills do exist within the remaining authorities, they are not adequately utilizing them in the important PFI areas of risk assessment, evaluation and transfer. It would be reasonable to assume that other areas of local authority operation, such as Finance or Legal Services, would be involved in the risk elements of PFI, but such involvement may lack the more holistic, corporate view of risk management found in the private sector. It may also reinforce the traditional professionalism/departmentalism associated with local authority decision making.

The involvement of risk managers/management function after the initial approval of the projects was greater than at the earlier stages, with nine (75 per cent) authorities proceeding with projects utilizing their services. Interestingly, however, this *post hoc* involvement revealed some inconsistencies. There was no strong connection between involvement in the decision-making process and involvement subsequently, with some respondents not being involved after approval despite earlier involvement and vice versa. Where there was *post hoc* involvement there was again a range of activity, including such complex areas as Monte Carlo simulations. In general, however, there was a much greater emphasis on the provision of insurance advice. This would suggest that decisions had already been taken on risk identification, evaluation and allocation, with or without in-house risk management consultation, and that the main focus after approval was to ensure that the risks retained by the local authority were covered adequately by insurance. This does, of course, beg the question of whether risk identification, evaluation and allocation were properly addressed in the first place, and further reinforces the view that the very narrow focus of risk management as being predominately insurance management still holds true in many Scottish local authorities.

Further evidence of this emphasis on insurance is provided by the respondents' own perceptions of their knowledge and training in PFI/PPP. Only seven (50 per cent) of those from authorities who have either proceeded or are still considering the position felt that they had sufficient knowledge. Of more concern, however, was the fact that 44 per cent of those who had been actively involved in the process felt they lacked sufficient skills. Further analysis of narrative responses indicated that this lack of confidence was more noticeable in respondents who had been involved in the 'non-insurance' aspects of risk management, e.g. Monte Carlo simulations and other financial decision-making techniques. Those whose involvement was restricted to insurance advice felt much more confident in their ability. This raises two important issues, i.e. a general risk management skills gap which local authorities must address and, more worryingly in the short to medium term, the involvement of staff in key areas of multi-million pound projects who lack the requisite skills. Given the abundance of risk management skills which the private sector partners will possess, this only reinforces the view that the PFI playing field is anything but level.

One of the, mainly anecdotal and unsubstantiated, criticisms of PFI has been the cost to the public sector of employing consultants. Our survey results would appear to bear this out,

with nine of those that have proceeded, or that have still to make the final decision on the PFI project, utilizing risk management consultants. One authority (11 per cent) used an insurance company, one (11 per cent) used a management consultancy and seven (78 per cent) used insurance brokers. In the majority of cases (66 per cent), these consultants were used in addition to the in-house risk management function and, based on the narrative responses, appeared to have provided predominately insurance-related advice. There was no evidence that they were giving advice on the more complex elements of risk identification, evaluation and transfer. Perhaps surprisingly, however, nine (100 per cent) respondents felt that the services provided by the consultants could not have been adequately provided by the in-house team.

The responses to consultants' involvement raises several issues that would require much more detailed investigation, such as if both in-house teams and consultants are providing mainly insurance-related advice, who is advising on the other, more complex aspects of PFI and risk? Furthermore, if consultants are providing insurance advice which, despite its being their apparent *raison d'être*, in-house teams feel incapable of providing, what is the level of expertise existing within local authorities? Once again, the skills imbalance between the private and public sectors is thrown into sharp relief.

Respondents were invited to comment on any PFI risk management issues not covered in the questionnaire and ten (44 per cent) chose to do so. A variety of comments were made, but at the heart of many of these were the interlinked views that risk management was core to the PFI process, the authorities' own risk manager/risk management teams should be used, but at present many local authority risk managers lacked the necessary skills.

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

Conclusion

This article has outlined the context and background underpinning the PFI/PPP policy being pursued in Scottish local councils. The policy has been pursued by all parties across the political spectrum – it was introduced by the Conservatives in 1992, continued by the New Labour government in 1997 and is being implemented by the Labour-Liberal Democrat Scottish Executive. Despite this supposed political consensus the policy continues to generate some of the most heated debate in Scottish politics. However, we have not concerned ourselves with the wider political issues raised by PFI/PPP. Instead we have concentrated on the implementation of the policy at a local level.

The response rate to our survey was encouragingly high (72 per cent), but the issue of response and non-response bias must still be considered. Not all respondents were titled 'Risk Manager', although the vast majority either were, or had that term in their job title. Of the nine non-respondents, none of these was from authorities that have a specific risk manager. If the risk management function is carried out, it is likely to be as part of the duties of an insurance or finance officer. It is possible, therefore, that these non-respondents would have had a different view on risk management and PFI, but given the relatively unsatisfactory picture which the actual responses from risk managers portray, it is unlikely that they would have presented a more positive view of the research problem.

Ball *et al.* (2000) confirm that PFI projects in general, and the risk transfer elements of these in particular, are subject to central government approval. Theoretically, therefore, a safeguard exists to ensure that local authorities do not make bad VFM judgements, although the practical evidence would suggest that the basis for making such judgements is seriously flawed. The evidence from our survey would suggest that scope exists for poor risk management decisions in Scottish local authorities. The degree of risk management involvement is variable, and where it does exist its extent is frequently limited in scope, primarily to the risk financing aspects (i.e. insurance of residual risks). This finding tends to support the view (see,

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

for example, Broadbent & McLaughlin, 1999; Gaffney & Pollock, 1997) that risk transfer is unclear, poorly understood and weighted in favour of the private sector. A key issue for local authorities is whether or not risks are actually identified and, subsequently, transferred to the private sector. The evidence on whether or not they are doing this is, at best, sketchy, and, at worst, non-existent. The contentious political nature of PFI and the secrecy surrounding the, supposed, commercially sensitive aspects of its operation has resulted in major difficulties in post-implementation evaluation.

Our research is silent on whether some officer or department, other than the risk manager/management function, is involved in the fine detail of risk transfer in PFI projects, although we must accept that this is likely. Even if others are involved (e.g. lawyers or finance staff), it is arguable whether they will have the breadth of knowledge of risk management, in a corporate sense, which is likely to exist within the private sector partners. Recent IPPR (2001) research suggests that the status and career structures of procurement officers in the public sector need to be enhanced in order to equip the public sector to work more effectively in commercial relationships with external bodies. This, together with the evidence presented here as regards PFI risk management in Scottish local authorities, suggests that Grout's (1997) view on bias against the private sector is invalid.

Given central government's enthusiasm for it, PFI/PPP is a fact of life for local authorities. Although the PSC exists as a mechanism for comparing the cost of totally public provision of capital projects, the prevailing view is that government will lean towards PFI/PPP wherever possible, despite a paucity of VFM evidence. This is likely to lead to an ever-increasing number of PFI/PPP projects and a concomitant rise in risk transfer considerations. Our study would suggest that many Scottish local authorities are ill-prepared to address these considerations. At present the complexity of PFI/PPP deals means there is little input from elected councillors. It is vital, therefore, that officers have the necessary skills. However, it would appear that the private sector will retain a substantial advantage over them in the arena of risk transfer negotiations. Local authorities, for a variety of reasons, have adopted the principles of risk management from the private sector, but, certainly in the context of PFI projects, they have much to do on operationalizing its practices.

References

Accounts Commission (1999) *Shorten the Odds: A Guide to Understanding and Managing Risk.* Edinburgh: Accounts Commission.

Adams, J. (1995) *Risk.* London: UCL Press.

Akintoye, A., Fitzgerald, E., Hardcastle, C. & Kraria, N. (1999) *Local Authority Risk Management and the Private Finance Initiative.* London: Royal Institute of Chartered Surveyors.

Akintoye, A., Taylor, C. & Fitzgerald, E. (1998) Risk analysis and management of Private Finance Initiative projects, *Engineering, Construction and Architectural Management*, 5(1), pp. 9–21.

Ball, R., Heafey, M. & King, D. (2000) Private Finance Initiative – a good deal for the public purse or a drain on future generations?, *Policy and Politics*, 29(1), pp. 95–108.

Beck, U. (1992) *Risk Society: Towards a New Modernity.* London: Sage.

Best Value Task Force (BVTF) (2000) *Best Value in Local Government: Long Term Arrangements.* Edinburgh: Scottish Executive.

Blair, T. (1998) *Leading the Way: A New System for Local Government.* London: Institute of Public Policy Research.

Broadbent, J. & McLaughlin, R. (1999) The Private Finance Initiative: clarification of a future research agenda, *Financial Accountability and Management*, 15(2), pp. 95–114.

Centre for Public Services (2001) Private Finance Initiative and public private partnerships: what future for public services? Available at www.centre.public.org.uk/briefings/pfi_and_ppp.html

Coleshill, P., Gibson, A., Jaconelli, A. & Sheffield, J. (1998) The Private Finance Initiative: private opportunity at the public's cost?, *Scottish Affairs*, 24, pp. 128–142.

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007

COMMUNITY PLANNING WORKING GROUP (1998) *Report of the Community Planning Working Group*. Edinburgh: Scottish Office.

DCMS (2000) *Risk Management Framework*. Department of Culture, Media and Sport. Available at www.culture.gov.uk/role/index.html

DETR (1998a) *Local Government and the Private Finance Initiative: An explanatory Note on PFI and Public/Private Partnerships in Local Government*. London: HMSO.

DETR (1998b) *Modern Local Government: In Touch with the People*. London: DETR.

DETR (1998c) *Modernising Local Government – Improving Local Services through Best Value*. London: DETR.

DETR (1998d) *Modern Local Government: Guidance on Enhancing Public Participation*. London: DETR.

DETR (2000) *Modernising Local Government: Improving Local Financial Accountability*. London: HMSO.

DOWLEN, A. (1995) Learning to manage risk in public services, *Executive Development*, 8(2), pp. 19–24.

DTI (2000) *General Public Procurement Principles*. Department of Trade & Industry. Available at www.dti.gov.uk/about/procurement/procua1-5.htm#a4

EVH (2001) *Developing and Implementing an Effective Risk Management Strategy: A Guide for RSLs*. Glasgow: Employers in Voluntary Housing.

FONE, M. & YOUNG, P. (2000) *Public Sector Risk Management*. Oxford: Butterworth-Heinemann.

GAFFNEY, D. & POLLOCK, A. (1997) *Can the NHS Afford the Private Finance Initiative?* London: British Medical Association.

GIDDENS, A. (1998) Risk society: the context of British politics, in J. Franklin (Ed.) *The Politics of the Risk Society*, pp. 23–34. Cambridge: Polity Press.

GLAISTER, S. (1999) Past abuses and future uses of private finance and public private partnerships in transport, *Public Money and Management*, July–September, pp. 29–36.

GROUT, P. (1997) The economics of the Private Finance Initiative, *Oxford Review of Economic Policy*, 13(4), pp. 53–67.

HARROW, J. (1997) Managing risk and delivering quality services: a case study perspective, *International Journal of Public Sector Management*, 10(5), pp. 331–352.

HENDERSON, J. (1999) The place of risk in the Private Finance Initiative. Paper presented at the 1999 CIPFA Scottish Risk Management Conference, Edinburgh.

HM GOVERNMENT (1999) *Modernising Government*. London: HMSO.

HOGGETT, P. (1996) New modes of control in the public service, *Public Administration*, 74, pp. 9–32.

HOOD, J. & KELLY, S. (1999) The emergence of public sector risk management: the case of local authorities in Scotland, *Policy Studies*, 20(4), pp. 273–283.

HOOD, C., SCOTT, C., JONES, O., JONES, G. & TRAVERS, T. (1999) *Regulation inside Government*. Oxford: Oxford University Press.

HOUSE OF COMMONS TREASURY SELECT COMMITTEE (2000) *HC 706 Fifth Special Report: The Private Finance Initiative*. Available at www.publications.parliament.uk/pa/cm199900/cmselect/cmtreasy/706/70602.htm

HOUSING CORPORATION (2001) *A Strategy for Success: Effective Risk and Business Management*. Available at www.housingcorp.gov.uk/pubs/documents.htm

ILGRA (2000) *Risk Assessment and Risk Management: Improving Policy and Practice within Government Departments*. Interdepartmental Liaison Group on Risk Assessment. Available at www.hse.gov.uk/dst/ilgra/minrpt2.htm

IPPR (2001) *Building Better Partnerships: The Final Report of the Commission on Public Private Partnerships*. London: IPPR. Available at www.ippr.org.uk/pub/covers/cppp.pdf

LINDSAY, I. (2000) Editorial. Available at www.scottishleftreview.com/html/Issue2/editorial.htm

LUPTON, D. (1999) *Risk*. London: Routledge.

MAYSTON, D. (1999) The Private Finance Initiative in the National Health Service: an unhealthy development in new public management, *Financial Accountability and Management*, 15(3), pp. 249–274.

MCGARVEY, N. (2001) Accountability in public administration: a multi-perspective framework of analysis, *Public Policy and Administration*, 16(2), pp. 17–28.

NAO (2000) *Supporting Innovation: Managing Risk in Government Departments*. London: National Audit Office.

OSBORNE, D. & GAEBLER, T. (1993) *Reinventing Government*. Reading, MA: Addison-Wesley.

POLLOCK, A. & VICKERS, N. (2000) Private Pie in the Sky, *Public Finance*. Available at www.cipfa.org.uk/publicfinanace, accessed 14 April 2000.

PRIVATE FINANCE PANEL (1995) *Private Opportunity, Public Benefit: Progressing the Private Finance Initiative*. London: Private Finance Panel/HM Treasury.

PYPER, R. (2001) Civil service management and policy, in B. Jones, D. Kavanagh, M. Moran & P. Norton (Eds), *Politics UK*. London: Longman.

RHODES, R. A. W. (1994) The hollowing out of the state, *Political Quarterly*, 65, pp. 138–151.

RHODES, R. A. W. (1997) *Understanding Governance*. Buckingham: Open University Press.

ROSE, R. (1990) Inheritance before choice in public policy, *Journal of Theoretical Politics*, 2, pp. 263–291.

SCOTTISH PARLIAMENT (2001) *Public–Private Partnerships and the Private Finance Initiative: A Review of Recent Literature*. Edinburgh: Scottish Parliament Information Centre.

STOKER, G. (1999) The moderniser's guide to local government, in G. Hassan & C. Warhurst (Eds.) *A Moderniser's Guide to Scotland – A Different Future*. Edinburgh/Glasgow: Centre for Scottish Public Policy/Big Issue in Scotland.

STOKER, G. (2000) The challenge of governance. Unpublished manuscript.

UNISON (1997) *PFI: Dangers, Realities, Alternatives*. London: Unison.

UNISON (2001) *Public Service, Private Finance*. London: Unison.

VAN HAM, H. & KOPPENJAN, J. (2000) Public private partnerships in port development: assessing and managing risk. Paper presented at the Fourth International Symposium on Public Management, Erasmus University, Rotterdam.

VINCENT, J. (1996) Managing risk in public services: a review of the international literature, *International Journal of Public Sector Management*, 9(2), pp. 57–64.

WARING, A. & GLENDON, A. (1998) *Managing Risk: Critical Issues for Survival and Success into the 21st Century*. London: International Thomson Business Press.

WRIGHT, T. (2001) Finding the Third Way, in B. Jones, D. Kavanagh, M. Moran & P. Norton (Eds), *Politics UK*. London: Longman.

Downloaded By: [NEICON Consortium] At: 13:31 13 July 2007