PPPs - Partnership Or Plunder?

by Dexter Whitfield, Alex Doherty

In a detailed interview Dexter Whitfield author of ‘Global Auction, of Public Assets’, describes the damaging effects of so-called Public Private Partnerships. He outlines why they are a disastrous way to provide essential services and he details a democratic alternative to PPPs.

First published: 21 March, 2010 | Category: Economy
(http://www.newleftproject.org/index.php/site/categories/C7)

Dexter Whitfield is director of the European Services Strategy Unit at the Australian Institute for Social Research. He is author of ‘Public Services Or Corporate Welfare’ and the new book ‘Global Auction Of Public Assets’. He was speaking to Alex Doherty.

What exactly are PFIs and PPPs? Why do you object to them?

The Private Finance Initiative (PFI) is a type of Public Private Partnership (PPP) in which the private sector designs, builds, finances and operates infrastructure projects for the public sector. A special purpose company is formed by a consortia consisting of the construction company, bank or infrastructure investment fund and the facilities management company to implement the project over a 25-40 year period.

A strategic partnership PPP is a 10-15-year multi-service Â£50m-Â£600m contract between a public body and a private contractor. Between 50 - 1,000 staff transfer or are seconded to a private contractor or to a Joint Venture Company (JVC) established between the local authority and contractor. Strategic partnership PPPs cover information technology, corporate and/or technical services. PPPs are ultimately financed almost exclusively by the public sector through regular payments from revenue budgets.

The 'end of PFI' has been predicted because of the financial crisis but this had little substance. The Tories have indicated they may abolish PFI but PPPs will continue and it is foolhardy to believe that a bit of rebranding will signify meaningful change. In fact new PPP models are being developed â€“ three councils are currently 'piloting' Â£2bn whole service 25-year highway contracts â€“ and the Project Delivery Organisation or integrator model takes over responsibility for both private and public investment in an authority or government department.

PPPs expand the marketisation and privatisation of public services. They result in the rundown of public provision, erode skills and loss of intellectual knowledge. The idea that facilities will revert to direct public control at the end of the 25-40 year contract period is not plausible because the parallel rundown of the public sector by then will almost certainly have reached the point when its ability to manage and operate the facilities will be limited. The likely scenario is continued outsourcing or another PPP project.
There is no discernable boundary between constructing and operating buildings and the provision of core services, such as teaching and clinical services. The notion that capital is 'content' with the scope of PPPs or the private sector is 'not interested' in delivering core services is naive. New PPP models, accompanied by the mutation of privatisation from the original sale of assets and outsourcing (see typology in Whitfield, 2006), provide opportunities for the private sector to deepen its role in the provision of core services. The public sector represents a vast additional market for capital â€“ that is what is at stake.

The way that PFI/PPPs are approved and deemed to represent Value for Money is contrived. By this I mean the deliberate use of selected historic public sector procurement performance data that is compared with future private sector performance. It is no coincidence that the major construction companies are evident on both data sets. The comparators always assume, conveniently, that the private sector is more cost effective and efficient than the public sector. For example, Value for Money assessments systematically assume that construction, life-cycle maintenance, the cost of utilities, and the cost and performance of facilities management services will be more advantageous in a PFI/PPP procurement compared to conventional public sector procurement. If the public sector option comes out best, the PFI/PPP option is dead. Hence the motive to contrive a different situation. Many PFI/PPP proceed despite a minute difference in VFM.

Investment in public infrastructure supports economic development and employment. It matters what type of infrastructure is built â€“ for example the American Recovery and Reinvestment Act of 2009 has demonstrated that every US$1bn investment in public transport supports 16,500 job/months compared to 8,800 job/months for highways. PPPs incorporate the outsourcing of design, finance and facilities management of buildings. This frequently reduces the number of jobs, terms and conditions and fragments trade union organisation.

The final point is crucially important and concerns private sector performance. Globally nearly a thousand PPP projects, valued at over US$500 billion, have been terminated or suffered major distress. Numerous contracts had to be renegotiated. Sixteen projects PFI/PPP projects in Britain have been terminated (including Metronet's London Tube contract, Skye Toll Bridge, Royal Armories, National Physical Laboratory and several local government strategic partnerships) and many more were abandoned before procurement was either started or completed. These are in addition to rail, education, ICT, health and leisure privatisation failures. A national audit of outsourced public sector contracts that have been terminated in the last decade would run into hundreds.

Industry lobby groups and contractors constantly criticise government and public provision to avoid turning the spotlight on private sector performance in delivering public services. They conveniently ignore the fact that governments around the world are heavily involved in promoting, planning, programming, facilitating, guaranteeing, providing cheap loans and subsidising PPPs and private investment.

The UK is something of a trailblazer when it comes to PPPs. What has been the impact of PPPs in the UK?

The impact of PPPs can be assessed by asking two questions. Did PPPs achieve the claims made by them and does their performance represent a step change compared to conventionally procured public sector contracts? The answer to both is a resounding 'no'.

On the positive side, PPPs have reduced delays and cost overruns, promoted whole life costing and provided a higher degree of price certainty. They have also led to construction companies being proactive in introducing green building systems and controls and a more corporate-wide approach to ICT. These have been aided by the government establishing national building programmes for schools, colleges and health centres. But these benefits are not exclusive to PPPs or the private sector. Many public sector projects have achieved the same benefits.

I assessed PPP performance, drawing on research in Britain and elsewhere, under a series of headings, such as design and innovation, affordability and cost, risk transfer, quality of service, governance and accountability, economic and social impact, social justice, the quality of employment and public sector capability and planning. The case against PPPs is overwhelming and the evidence is set out in chapter 9 of Global Auction of Public Assets.
PPPs do nothing to improve and develop the public sector, in fact they feed off examples of historic poor performance in which the private sector were equally culpable. Construction companies have always been adept in claiming cost increases and shirking responsibility for delays. Even if the debt is off-balance sheet, it still has to be financed from public sector revenue budgets for the contract period, and remains a public liability.

PPPs transfer some risks to the private sector but at a price. Despite this between 22% - 35% of PPPs suffer cost overruns and 24% - 31% are delayed according to National Audit Office studies in 2003 and 2008.

You claim that PPPs have “similar structural flaws to the causes of the current global financial crisis”. What do you mean by this?

It is important to understand the key structural elements of Public Private Partnerships and not be taken in by the 'partnership' hype. The structural elements include:

Special Purpose Companies: A new company is established for each project by the consortia, usually the construction company, bank or major investor and the facilities management company. PPPs were usually financed 90/10 debt/equity ratio although the economic crisis led to an equity accounting for a higher proportion of the company's financial structure.

Secondary market: PPPs can be refinanced once construction is completed and the project is operational. At this stage the major risks associated with construction have been eliminated and loans can be often be refinanced at lower interest rates. PPP contracts in Britain require that certain financial benefits to be shared equally with the public sector. The shareholders in the project company can also sell their equity in the to other investors, but in this case they do not have to obtain approval nor share the financial gains with the public sector. A secondary market has developed in Britain, and is emerging in other countries such as Canada and Australia, with new investment companies/funds dealing specifically in acquiring stakes in PPP companies. This has led to financial companies owning equity stakes in a large number of PPP project companies. For example, Semperian PPP Investment Partners manages 108 PPP assets with value of Â£1.35bn. It was the first secondary market fund, set up in 2001 as Secondary Market Infrastructure Fund (SMIF) by Babcock and Brown and Abbey National.

Two years later it was acquired by Star Capital Partners. Halifax Bank of Scotland and AMP Capital Investors followed by a partnership with Global Solutions (GSL) and acquired by Land Securities Trillium in February 2007. Land Securities turned it into a joint venture company, Trillium PPP Investment Partners, raising Â£1.1bn debt and equity in 2008. It was sold again in February 2009 to Semperian.

Securitisation: This is another form of financial engineering in which financial institutions seek to spread the risk of investments by transferring them to other financial institutions. Moved off-balance sheet improves the return on income and equity and they obtain fees in the process. Another technique is to spread share ownership across a number of different investment funds, a technique well practiced by Macquarie Bank. 'Portfolio management' often involves the acquisition of assets followed by the sale of small share stakes and is in essence another type of securitisation. For example, Global Infrastructure Partners acquired Gatwick Airport from BAA (Ferrovial, Spain) late last year. It then sold a 15% stake to the Abu Dhabi Investment Authority, a sovereign wealth fund and a 12% stake to South Korea's National Pension Service.

Complexity: PPPs create financial, organisation and legal complexity, which leads to specialisation and wider use of management consultants and lawyers. Client and bidders in every PPP project have their own consultants and legal teams, thus creating a new market, a vested interest in expansion of the PPP model, and little interest in knowledge transfer to the public sector.

Off-balance sheet financing: About half of PFI investment in Britain to date has been off-balance sheet, which means that the debt arising from what is in effect capital expenditure does not appear as public debt despite it being entirely financed by the public sector. PFI is financed from public sector revenue accounts through a monthly unitary charge consisting of the lease or use of the facilities (reflecting the construction and finance costs over 25-40 years) and the facilities management services such as cleaning, catering and so on. PPP strategic partnerships, such ICT and back office projects in local government, are also financed from revenue budgets.
Basically, off balance sheet financing in both public and private sectors is a means of concealing the true level of capital expenditure and thus the level of debt. Companies or organisations thus appears to have fewer financial commitments or liabilities than do in reality.

**Commercial confidentiality and lack of accountability:** Both the procurement process and the operation of PPP projects, usually 25 â€“ 40 years, is dominated by secrecy. 'Commercial confidentiality' is used extensively by the public and private sectors to prevent the disclosure of options appraisals, business cases, contracts and project performance. This is compounded by the secondary market because it imposes another corporate layer with minimal accountability and transparency. Construction and financial companies may issue a press release when they sell equity in a PPP project company, but most are not required to issue a Stock Market Notice as the transaction is not considered a material financial interest. Privately-owned companies are not required to make such disclosures.

**Outsourcing:** The full range off facilities management services are rarely delivered by one contractor. Instead, waste disposal, catering, transport, grounds maintenance are usually outsourced to subcontractors. The wider the range of services included in the scope of the contract the larger the scale of outsourcing. PPP strategic partnerships often have a secondary contractor and may also subcontract specific transformation processes or services.

**Marketisation with deregulation and minimal oversight:** Design, build, finance and operate contracts facilitate the run-down of publicly provided services and the expansion of private markets. In-house design and technical services, and Architectural design, project management, PPPs also create new markets in project finance, securitisation, insurance, the provision of technical and legal advice and due diligence. A PPP information and conference industry has mushroomed. The deregulation of financial, labour and other regulation frameworks has been accompanied by minimal oversight with lax inspection and monitoring regimes. Contractors have been encouraged to 'self-monitor' using less than rigorous 'key performance indicators'.

**Neoliberal model of public service transformation:** New Labour fervently adopted neoliberal public management that mainstreamed performance management, commissioning, outsourcing, contestable markets, private finance and partnerships.

All of these elements were mirrored in the mortgage crisis and ultimately the financial system and a key cause of the financial crisis and subsequent recession.

**What is your proposed alternative to PPPs?**

The alternative to PPPs is publicly provided and operated infrastructure.

Firstly, a new public infrastructure contract is urgently required which maintains a separation of the design, finance and construction responsibilities. A new model, Construction Management At-Risk (CMR), has been successfully tested in the US in which the client selects the construction manager, based on qualifications, before the design stage is completed. The architect and construction manager work together in the final stage of the design process following which the contractor gives the client a guaranteed maximum price and coordinates all the subcontracted work. This approach strengthens coordination, enhances transparency, delivers efficiencies and minimises delays. This approach should create a new evidence base of public sector contract performance and help to nullify the use of old data that has been peddled globally by the PPP lobby, World Bank, IMF and development banks.

Secondly, demands for increased investment and fiscal stimulus measures must include demands for public investment in publicly owned and operated projects â€“ policies which duck the public-private policy divide only provide more scope for the asset monetization/PPP industry. A publicly controlled infrastructure bank to invest public money will be beneficial but not one modelled on the European Investment Bank, which has financed and expanded the PPP model. Rapid deficit reduction policies should be opposed because they are primarily motivated by vested interests to create the conditions that promote more PPP/asset monetisation projects.

Thirdly, global reforms should include a Financial Transaction Tax, firewalls between investment and commercial banking, the use of tax havens banned, controls on private equity and hedge funds and prohibit off-balance sheet financing. This new regulatory framework must be accompanied by policy changes such as stopping the
financialisation of pensions and other services and both EU and WTO public sector marketisation policies.

Fourthly, a new evaluation framework including a comprehensive 25 stage Public Infrastructure Evaluation Framework, a PPP Infrastructure Stress Test, and every project assessed against a governance and accountability template. The planning and procurement process must be democratised with community and trade union participation and full transparency.

Fifthly, a progressive public management for the 21st century is required that focuses of in-house delivery, capacity building, the democratisation and consolidation of public bodies and agencies; a genuine holistic and integrative approach to economic, social, health, environmental and sustainable development policies.

Finally, these policy changes would have to be accompanied by strategies to reduce or eliminate the deal flow of new PFI/PPP and privatisation/asset monetisation projects. New controls would have to be imposed on existing PFI/PPP projects to radically improve democratic accountability and transparency. I set out a 10-point plan in Global Auction of Public Assets.

You argue that PPPs are undemocratic. How do you support that claim?

The PPP procurement process is shrouded in secrecy and the evaluation of option appraisals, business cases and private sector bids use narrow criteria. Gateway Reviews are carried out by peer group officers and focus on getting the process ‘right’. They are not designed to challenge the rationale for the project. Furthermore, although most PPPs are considered by an oversight and scrutiny committee, in my experience, this is superficial because elected members rarely understand the project and thus do not know the key questions to ask. Most scrutiny events are officer-led powerpoint sessions followed by a few token questions.

A degree of confidentiality is essential to protect both public and private interests. However, ‘commercial confidentiality’ is systematically abused. There is a degree of collusion between public managers, contractors, consultants and lawyers to avoid accountability and thus a challenge to policies and proposals.

Once the PPP is operational ‘commercial confidentiality’ continues. Strategic partnerships in local government, including those operated through joint venture companies, are usually ‘closed’ between the council and contractor. A strategic partnership will usually have a three-tier ‘governance structure’ consisting of a strategic, operational and implementation boards, yet it is extremely difficult for trade unions to obtain information, let alone participate, and virtually impossible for community organisation representatives.

The problem was exemplified by an Audit Commission study of strategic partnerships in local government which accounted for Â£7bn public expenditure. The Commission’s study, For better, for worse: Value for money in strategic service-delivery partnerships, 2008, did not identify the case studies, councils or contractors and withheld basic information. This made a mockery of the Commission’s status as an ‘independent auditor’ and accountable to Parliament. The secrecy label affords the private sector a degree of protection, which is neither warranted, nor in the public interest. It appeases or avoids the risk of legal action by private contractors who want to challenge research and performance findings.

What kind of economic system do you advocate?

A socialist economy which limits and regulates the power of markets based on principles and values such as social justice; democratic accountability, participation and involvement and transparency; quality employment and labour standards; universal provision; public interest; sustainable economic development. Collective and personal values would include honesty, integrity, objectivity, equality, competence and selflessness.

The global financial crisis has created a unique opportunity to radically redefine the role of government, the public sector and welfare state. But the political neoliberal consensus has electively limited the debate to the budget deficit and public spending cuts whilst curtailing debate on increasing government revenue. There is little vision or ability to think about the future within the main political parties.