The future of infrastructure financing

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Is there a public alternative to the privitisation life?

THE MIXED MESSAGES IN INFRASTRUCTURE FINANCE

The Conservative government's 2018 budget announced that no more private finance initiative (PFI) and PF2[1] projects would be approved: "Government will not be seeking a like-for-like replacement for these models. The government is open to exploring new ways to use private finance in government projects, but the benefits brought by private finance must outweigh the additional cost to the taxpayer of using private capital, and the government will not consider proposals demonstrating the same characteristics as PFI or PF2."[2] However, with infrastructure spend and investment a stated government objective, their plans to finance projects remain unclear and contradictory.

The 25-year UK experience of PFI[3] led to many negative impacts, including the following.

- **Affordability:** high PFI finance costs financed via revenue budgets led to budget cuts in non-PFI services.[4]
- **Risk transfer was costly and exaggerated:** "the superiority of the PFI is based on time and cost overrun arguments for which there is no evidence".[5]

1 A version of PFI launched by the coalition government in 2012.
2 HM Treasury and Infrastructure Projects Authority (2019) *Infrastructure Finance Review*. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785546/infrastructure_finance_review_consultation_web_version.pdf
3 Audit Scotland (2020) *Privately Financed Infrastructure Investment: The Non-Profit (NPD) and Hub Models*. https://www.audit-scotland.gov.uk/uploads/docs/report/2020/nr_200128_npd_hubs.pdf
4 National Audit Office (2015) *The choice of finance for capital investment*. https://www.nao.org.uk/wp-content/uploads/2015/03/The-choice-of-finance-for-capital-investment.pdf
5 Pollock A, Price D and Player S (2007) 'An Examination of the UK Treasury's Evidence Base for Cost and Time Overrun Data in UK Value-for Money Policy and Appraisal', *Public Money & Management*, April, 127-133

- **Value for money** has frequently been systematically calibrated to provide the 'right' answer to allow projects to proceed.[6]
- **Poor operational performance:** 27 contract terminations and 12 buyouts represent a 4.75 per cent UK failure rate, which is higher than the 4.5 per cent rate of cancelled PPP contracts in developing countries. Additionally, 46 UK PPPs experienced major problems.[7]
- **Over-reliance on consultants and lawyers** in PFI schemes: led to a loss of public sector capability.[8]
- **High reward:** banks and construction companies obtained an average 28.7 per cent annual rate of return when they sold equity in PFI project companies in 462 secondary market transactions between 1998 and 2016. This was more than double the 12 to 15 per cent annual rate of return they had suggested they'd achieve in their final business cases suggesting poor value for money.[9]
- **Decline in working conditions:** many facilities management companies created a two-tier workforce with wide use of temporary contracts. For instance, private prison officers' total pay and benefits was between 9.9 per cent and 26.6 per cent less than the same grades of public sector prison staff.[10]

Given the evidence of significant problems with historic private and public sector partnerships, it is critical to explore how public-private partnership (PPP) models – of which PFI is just one famous example – define the UK's approach to infrastructure, and explore what can be done to mitigate the associated risks.

THE MODEL OF PUBLIC-PRIVATE PARTNERSHIP (PPP) IS THRIVING

There are currently approximately 700 operational PFI/PF2 projects in the UK. There are a further 51 non-profit distribution (NPD)/hub projects in

6 Whitfield D (2010) *Global Auction of Public Assets: Public sector alternatives to the infrastructure market and Public Private Partnerships*, Spokesman Books
7 Whitfield D (2020) *Public Alternative to the Privatisation of Life*, Spokesman Books
8 Ibid
9 European Services Strategy Unit (2017) *New evidence of the scale of UK PFI/PPP equity offshoring and tax Avoidance*. https://www.european-services-strategy.org.uk/wp-content/uploads/2017/10/PPP-profiteering-Offshoring-New-Evidence.pdf
10 Incomes Data Services (2015) *Pay, pensions and reward packages for private custodial service staff*, research report for the Office of Manpower Economics. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/409341/IDS_report_on_private_custodial_staff_March_2015_FINAL.pdf

Scotland – the first NPD project was signed in 2005 and superseded PFI in 2007 and was later developed into the NPD/hub programme – while the Welsh and Scottish governments have also adopted a mutual investment model (MIM).[11,12,13]

New models – devoid of PFI's reputation, but with many of the same fundamental problems – now allow public authorities to claim that they profit from project company dividend payments and the sale of equity. Some models – like MIM – claim further advantages, such as the provision of an ethical employment code, apprenticeships, local supply chain sourcing, and fewer outsourced services. But in reality the same advantages could be achieved through a committed public authority, rather than PPP.

"The emphasis on profit-sharing finance schemes in all the 'new' models does nothing to change the high cost of private finance"

The brutal truth is that the emphasis on profit-sharing finance schemes in all the 'new' models does nothing to change the high cost of private finance. Despite the rebranding, these are all PPP models, financed by the same financial institutions, built by the same construction companies and developed and managed by the same firms. Many have parent companies registered in offshore tax havens that had a dominant role in PFI projects. They are a derivative, not an alternative.

PPP IS NOT THE ONLY OPTION

There are many examples of the government's ongoing embrace of PPP. Take health, where PFI schemes have proven particularly contentious. The Local Improvement Finance Trust (LIFT) PPP model has privately financed renewal of the primary healthcare facilities in urban England since 2000, and this is set to continue. The £2.5 billion Community Health

11 Welsh Government (2017) *Mutual Investment Model: Questions and Answers for Local Authorities and Colleges*. https://gov.wales/sites/default/files/publications/2019-01/170822atisn11410doc04.pdf

12 Scottish Futures Trust (2019) *An options appraisal to examine profit sharing finance schemes, such as the Welsh Mutual Investment Model, to secure investment for the National Infrastructure Mission and best value for Taxpayers*. https://www.scottishfuturestrust.org.uk/storage/uploads/sftoptionsappraisalreportlowres.pdf

13 MIM allows the public sector to invest up to 20 per cent of the risk capital in PPP project companies and to meet the private investment classification. The public sector, in effect, becomes a commercial partner with the private sector in sharing the risks and rewards.

Partnerships (CHP) programme has built 340 primary care facilities through 49 PPP companies.

By contrast, the CHP programme recently launched Project Phoenix – a plan for six regional health infrastructure PPP companies for NHS England with 80/20 per cent private/public finance to support the transformation of local service provision. It could have led to wider privatisation of the NHS estate. However, this model was rejected by the government, which simultaneously announced six new directly publicly-funded NHS hospitals.[14] A month later, "20 hospital upgrades and 40 new hospitals" were promised.[15] Direct public investment is possible, where there is the will to deliver it.

It cannot be understated how much moving away from PPP is conditional on that will. Local authority capabilities to fund their own projects have been undermined by a decade of austerity. This means PPP may provide their only option for large-scale regeneration. For example, Lendlease Corporation – the Australian developer of retirement villages and UK PFI projects – currently has three large regeneration projects in London, and another in Birmingham, worth a combined £18.8 billion.

GLOBAL PPPS PROVIDE A STARK WARNING FOR THE UK

PPP continues to thrive in the UK, but it is also strong globally. Social impact bonds (SIBs) are a PPP model developed in the UK for early intervention and prevention services, which were catapulted on to the G20 agenda by the UK's Conservative government in 2014. Subsequently, several countries established national taskforces to develop SIB programmes and derivative models emerged, such as development impact bonds for the global south and environmental impact bonds in the US.

Education PPPs are established in Africa and India. For example, the World Bank's International Finance Corporation is an investor in Bridge International Academies (BIA), alongside the UK's Department for International Development. BIA operates 68 schools in Liberia's Educational Advancement Program, where "the gains in test scores are

14 Health Service Journal (2019) 'Exclusive: Private finance scheme for the NHS scrapped', news article. https://www.hsj.co.uk/finance-and-efficiency/exclusive-private-finance-scheme-for-the-nhs-scrapped/7026402.article

15 Conservative Party (2019) *Get Brexit Done: Unleash Britain's Potential*, manifesto. https://assets-global.website-files.com/5da42e2cae7ebd3f8bde353c/5dda924905da587992a064ba_Conservative2019Manifesto.pdf

most likely the result of five policy changes that could easily be implemented in regular public schools without any need for outsourcing to the private sector".[16] Pakistan had 4,300 schools in private management PPPs by late 2018, but an Oxfam study revealed major problems and limited performance.[17]

The threat of private equity fund ownership and operation of public hospitals is illustrated by the Northern Beaches Hospital in Sydney, Australia. It has a 60/40 public/private share of 488 beds, built and operated by Healthscope Limited under a 20-year £1.1 billion PPP contract. It opened in 2018, but staff shortages, and lack of supplies and drugs led to the cancellation of elective surgery. Two weeks after the opening, Brookfield Asset Management's Cayman Islands-registered Australian subsidiary made a successful £2.2 billion takeover for all 43 of Healthscope's private hospitals and health centres in Australia.

A drive to increase privately financed infrastructure in low- and middle-income countries was launched in 2015, orchestrated by the G20, World Bank, IMF, OECD, development banks and private equity funds. The World Bank's Global Infrastructure Facility (GIF) created a platform to help prepare and design complex PPP infrastructure projects to attract new sources of long-term private capital.[18] The Asia-Pacific Project Preparation Facility (AP3F) is a similar project managed by the Asia Development Bank to prepare, structure and market bankable PPPs for governments and provide technical, financial, legal and regulatory advice.[19]

"Private finance rarely reduces financial risk, but instead leads to new types of risk and costs for the public sector"

16 Klees SJ (2017) 'The Partnership Schools for Liberia: A Critical Analysis', *World Education Blog*. https://gemreportunesco.wordpress.com/2017/11/07/the-partnership-schools-for-liberia-a-critical-analysis

17 Afridi M (2018) *Equity and Quality in an Education Public Private Partnership: A study of World Bank supported PPP in Punjab, Pakistan*, Oxfam Research Reports. https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620529/rr-education-ppp-punjab-pakistan-020818-en.pdf

18 World Bank Group (2014) *World Bank Group Launches New Global Infrastructure Facility*, press release. https://www.worldbank.org/en/news/press-release/2014/10/09/world-bank-group-launches-new-global-infrastructure-facility

19 Asian Development Bank (2016) 'Asia-Pacific Project Preparation Facility', news release. http://www.adb.org/print/node/179559

The UN also supports PPPs. For example, the Addis Ababa sustainable development goals statement stated: "Blended finance instruments including PPPs serve to lower investment specific risks and incentivize additional private sector finance across key development sectors".[20] Private finance rarely reduces financial risk, but instead leads to new types of risk and costs for the public sector. The UN also developed The Economics of Ecosystems and Biodiversity Programme (TEEB) for global privatisation and commercialisation of nature and biodiversity.[21]

As global use of PPP – often supported by the UK government – increases, there will be mounting pressure to return to a default of continuing with the PPP model; in short, in investing in the continued legacy of PFI. And private finance remains strong enough to take any opportunity to take private control of public infrastructure. But the global experience of PPP should provide a warning that it remains high-risk, low-quality mode of infrastructure delivery and finance. It has by no means evolved into a viable model.

WHAT DO WE DO IN THE FACE OF PPP'S DOMINANCE?

National and global development of PFI is almost certain to have profound consequences. Private equity funds will increase their provision of core public services and, together with pension funds and other financial institutions, will expand secondary market trading to acquire more PPP and privatised assets. The vested interests of public authorities (client and possible investor); the project company; private equity funds and private contractors (owners and employers); and the worker's pension fund (increasingly an investor) will undercut worker and trade union campaigns for better pay and conditions.

In this context - and in an era of increasing demand, digitalisation, automation and the implementation of climate action policies. But how can we resist the dominance of the PPP model? Advocacy for a more sustainable approach to investment must focus on four key points.

Firstly, the case must be made for an alternative funding model. Publicly financed infrastructure should be prioritised to take advantage of low interest rates via the Public Works Loan Board. Although there is

20 United Nations (2015) *Report of the third International Conference on Financing for Development*. https://unctad.org/meetings/en/SessionalDocuments/ares69d313_en.pdf

21 See: www.teedweb.org

uncertainty about the state of the global and post-Brexit UK economies over the next decade, this approach will achieve significant benefits and cost savings.

Secondly, the reintegration of infrastructure and service provision is essential and must include democratic involvement in planning, design and delivery process that includes user/employee participation, transparency and radical public management.[22] Bringing together design and construction – in an integrated model - would reduce construction risk and cost, while enhancing long-term planning and environmental impact. A collaborative model, with strong protections against defects, was successfully piloted at Dudley College between 2011 and 2014.[23] In short, they demonstrate PPP is not the only model of partnership available to us.

"Without alternatives, the PPP model will continue by default"

Thirdly, with nationalisation of PFI a non-starter for at least the term of the Conservative government, we need to explore other ways out of existing arrangements. Terminations, buyouts and demands for bailouts will continue, although it is difficult to predict the rate of such events. And further positive action is possible. Local authorities and NHS trusts have rights where they identify poor performance. Working with trade unions and community organisations, they should look to terminate contracts where poor performance persists. An increased rate of terminations, plus the 50 PFI contracts that will conclude between 2020 and 2024, will accelerate the decline of privately-financed public infrastructure - and increase pressure across the UK for government to lay PPP to rest.

Fourthly, the systemic use of offshore tax havens and the continued growth of the secondary market in public infrastructure assets must be addressed in the UK and globally. Nine offshore secondary market infrastructure funds owned between 50 and 100 per cent of the equity in 334 PFI/PPP projects (or 45.4 per cent of PPP projects in the UK) in 2016. This shelters profits, increases public risk and reduces much needed transparency. It is an area

22 Whitfield, D, (2020) *Public Alternative to the Privatisation of Life*, Spokesman Books, Nottingham.

23 School of the Built Environment, Construction Management & Engineering (2018) *Delivering More for Less Under the IPI Model*, Final Research Report, Innovate UK/TSB Project Ref: 101345, University of Reading. https://docs.wixstatic.com/ugd/b66306_c49110df68af446091e293c1d4fe8650.pdf

where government could and should be convinced that they are getting a bad deal.

Without alternatives, PPP will continue by default. A strong emphasis on private finance remains at the heart of the nation's approach to infrastructure,[24] in a way oblivious to the poor track record of PPPs in a wide range of economic and social infrastructure.[25] Should that continue – should we fail to end the model that underpinned the PFI scandals of the last decade – we will lose hope of progress towards a public alternative to the privitisation of life.

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24 National Infrastructure Commission (2018) *National Infrastructure Assessment*. https://www.nic.org.uk/wp-content/uploads/CCS001_CCS0618917350-001_NIC-NIA_Accessible.pdf

25 European Services Strategy Unit (2017) *New evidence of the scale of UK PFI/PPP equity offshoring and tax Avoidance*. https://www.european-services-strategy.org.uk/wp-content/uploads/2017/10/PPP-profiteering-Offshoring-New-Evidence.pdf