

24 | Public Private Partnerships: The great wealth extractor

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Introduction

The collapse of the construction and facilities management company, Carillion in January 2018 generated two significant impacts in Ireland. First, it exposed the precarious structure of the construction industry, where companies like Carillion rely upon smaller firms to take on work as sub-contractors. When the collapse came, the subcontractors were left being owed substantial sums of money; this is what sparked the protests outside the Dail and the pickets outside the schools in Bray, Co. Wicklow last summer. Second, the collapse has once again brought the discussion about the nature and role of Public Private Partnerships (PPPs) to the fore. PPPs enable private companies like Carillion to profit from public money through building, financing and maintaining public infrastructure assets, such as schools, hospital and roads. Carillion's collapse delayed the delivery of five new schools and a college in Ireland and two hospitals in England. This article concentrates on the second impact and explores the nature and role of PPPs within Britain and Ireland.

There are now over 700 PPP projects in Britain with a further 33 in Northern Ireland and nearly 30 in the Republic. PPPs were originally introduced in Britain under the Conservative government in 1992 with the name the Private Finance Initiative (PFI); however, it was not until New Labour was elected in 1997 that the policy was re-branded, though not changed in substance, and the number of PPP project grew significantly. In Ireland the first bundle of PPP projects was introduced in 1997 with five schools and the Cork School of Music.

PPPs were presented as a policy that would benefit everyone – communities would get new schools or hospitals, that would have the best in private sector innovation. This would give better value for money for the taxpayer and the private sector partners would become committed long-term to providing services that cash-strapped gov-

ernments simply could not afford. We will see later that every one of these claims was either false or lacked any substance. Further there has been a series of failures of PPP projects; for example the first PPP hospital in Britain has been condemned as a fire risk; or the collapse of a wall at an Edinburgh school in January 2016. In Dublin the failure of a social housing PPP in 2008 led a community worker to comment: "This was the third time in five years that a plan had collapsed; it wasn't supposed to happen again. Just like the Titanic, PPP was supposed to be unsinkable."

A final introductory point: not just in these islands but across the globe there is a growing need for investment in public infrastructure projects – to upgrade existing infrastructure in developed economies and build new public infrastructure to aid the development of emerging economies. Management Consultants, McKinsey, estimate that an average of \$3.7 trillion needs to be invested in public infrastructure globally every year through to 2035. This need has led the World Bank and the IMF to adopt PPPs as a model for delivering public infrastructure internationally, which means the experience in Britain and Ireland over the past nearly three decades has relevance beyond our own shores.

The main thrust of the argument in this article is that PPPs are a complex mechanism that is designed to extract as much wealth as possible from providing public services. The next section explores the components of this mechanism. Subsequent sections show how PPPs are an expression of the broader changes in capitalism since the 1970s, the response by political parties and a conclusion which highlights the role of campaigns in creating a hostile environment for future PPPs.

Structure of the great wealth extractor

Public infrastructure procurement used to be a relatively sedate, simple, even boring aspect of government

activity. In contrast, PPPs have a complex and dynamic structure, but with one overriding principle: to create as many opportunities for private sector companies to generate profits from delivering public services. There are two main forms of PPPs: concessions, where the private sector partners receive their income from user fees (e.g. the toll roads in Ireland); and, design, build, finance, maintain (DBFM) where the income comes as annual payments direct from the public purse. It is the second form (DBFM) that is the main focus of this article as it is the most common form of PPP in these islands.

On the left-hand side of Figure 1, from the English National Audit Office, the conventional public infrastructure procurement is shown, where the Treasury (Department of Finance in Ireland) allocates resources to the relevant government department (e.g. Health, Education etc.) for a capital project; the department then engages with contractors who build the new infrastructure asset (e.g. school, hospital etc.). In conventional procurement the Treasury/Department of Finance is responsible for raising the funds, which is achieved either through tax-

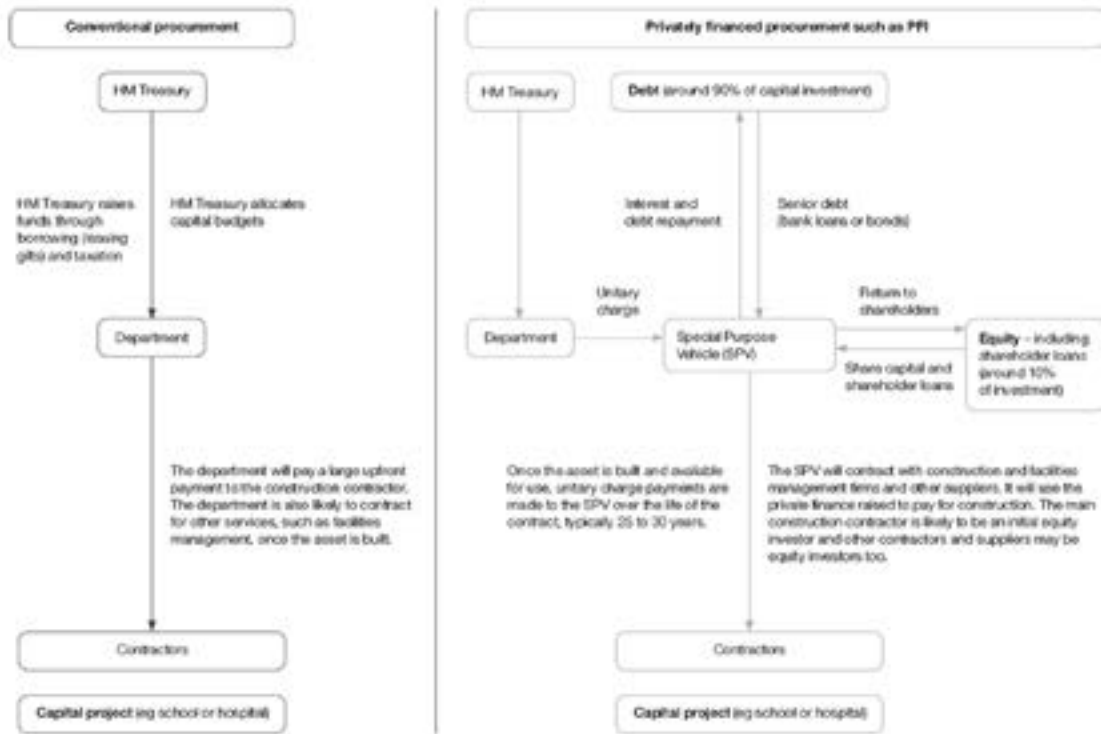
ation or government borrowing. It is important to note that government borrowing is the cheapest form of borrowing available, due to the low risk of default.

Looking at the other side of Figure 1, procurement using a DBFM project, the relationship between the Treasury/Department of Finance and the spending department remains in place; however, the money being passed to the spending department is not the full capital amount to pay for asset construction but an annual amount, known as a unitary payment. This term is explained below.

At the centre of any PPP structure is a special purpose vehicle (SPV) – although this is more accurately just a company – that raises the finance for the project and contracts with the construction firm and facilities management firm.

The contractual basis of this structure is seen by the Irish government and advocates of the PPPs as reducing the risk to the state when it comes to difficulties and delays with construction of the new asset, such as when Carillion collapsed: “The contractual mechanisms within a PPP project agreement are designed to limit the State’s

Figure 1
Comparison between private finance and conventional procurement



financial exposure in such a scenario.” Here we see the myopic attitude of Irish bourgeois politicians and their steadfast refusal to learn lesson from other jurisdictions. In England the collapse of Carillion left two hospital projects in Birmingham and Liverpool part completed, even with contracts signed. Further, there was a lack of any other party willing to take on Carillion’s role, ultimately forcing the Treasury into taking the project back in house. Another example of public money being used to bail out the private sector.

In Ireland, the SPVs affected by the collapse of Carillion were able to get a new construction partner, Woodvale, to complete the school buildings; however, it is not clear if additional funds were used to induce Woodvale into taking on the contract.

PPP projects typically last for 25 years or more and are highly dependent on debt being raised by the private sector partners. In many cases the debt will account for approximately 90 per cent of the total project finance; the remaining 10 per cent coming direct from the private sector partners either in the form of share capital or shareholder loans. Depending on the precise details of the project, the SPV also contracts with facilities management providers to cover a range of potential services which often include building maintenance, cleaning and catering. The unitary payment made by the public authority to the SPV is made up of two elements: first, a payment to cover the cost of construction of the asset and, second, a payment to cover the on-going services.

Multiple profit extraction mechanisms

We can now compare conventional procurement and private finance procurement looking for the component mechanisms that allow private sector companies to profit from the construction and maintenance of public assets. First, under the conventional procurement process it was, and still is, often the case that construction was carried out by a private sector building firm. This required a relatively straightforward negotiation between the public authority and the building company involving agreeing specifications and related costs; allowing the private contractor to make a profit.

In contrast there are, in addition to the basic PPP agreement, at least six mechanisms in which private sector firms can extract profit from PPP projects. Before explaining these mechanisms, it is important to note that the basic structure of a PPP project involves the private

sector making profits that are greater than if conventional procurement is followed. This is for two reasons – first, private sector borrowing is always more expensive than government borrowing because governments are assumed not to default on their debt repayments and hence are considered to be risk-free borrowers, hence the return (interest rate) on their borrowing is lower. Second, to attract private sector companies into PPP projects the overall return (profit) needs to be substantial. The UK Treasury have a normal expectation of a rate of return between 13-15 percent per project. When interest rates are so low and other investment opportunities carrying considerably more risk a return in this range is very attractive.

However, in addition to the already expensive basic model there are multiple mechanisms that allow profits to be made. The following explains six additional wealth extraction mechanisms embedded in PPP projects:

a. *Refinancing the debt* (following construction of the new asset): The construction phase is the highest-risk phase of a project, because if the school, hospital etc does not get built or is delayed then the unitary payments are delayed or not made, and no profit can flow. However, once construction is complete the risk profile of the project drops considerably, allowing the debt to be refinanced and in turn the project’s rate of return increases. For example, the investor rate of return of the Norfolk and Norwich Hospital PPP increased from 16.0 per cent to 60.0 per cent after refinancing took place two years into a thirty-year contract;

b. *Exorbitant interest rates on shareholders’ loans*: While only constituting 10 per cent of the overall project finance these funds are, in economic theory, supposed to be put at risk by the private sector partners. In reality, the shareholders provide loans, rather than shares. The benefit of this manoeuvre is that loans are charged to the SPV at high interest rates often in excess of the overall project rate of return, and interest is guaranteed to be paid, irrespective of whether the SPV is profitable;

c. *Selling their equity shares*: As already stated SPV is actually a misnomer and in reality should be a SPC (special purpose company) as all these SPVs are private limited companies, with shareholders. In the UK over the past twenty years a market has developed where the primary private sector partners as disposing of their shares in projects and in the process pocketing substantial profits. Initial studies estimate the rate of

return on these equity sales at between 25 and 29 per cent per annum, with divestment occurring on average six years into a project;

d. *Charging for changes in the contract:* As PPPs are based on contracts, each aspect of activity for the length of the contract (25 years or more) must be specified in advance and agreed by both parties to the contract. This means there is a lack of flexibility in PPP projects to adjust to changes in demographics or innovations in technology. It also means that as most contracts are incomplete and cannot anticipate every eventuality, when something arises outside the scope of the contract the private sector partners have the opportunity to engage in profiteering. For example, in 2006 the Channel 4 programme *Dispatches* uncovered a case where a hospital was charged £333 to change a light fitting and a case of a local authority “shelling out tens of thousands of pounds a month for meals and cleaning services in a school which closed” the previous year. Similar excessive charging has been found in Irish school PPP projects;

e. *Undermining service workers’ pay and conditions:* In many cases the new public asset is a replacement for an existing one. As part of the project the new facilities management providers take on existing staff through the ‘Transfer of Undertaking, Protection of Employment’ (TUPE) rules. This is supposed to protect the transferred staff with their new employer. However, there is mounting evidence that TUPE is ineffective. For example, Rory Hearne reports cases of caretaking staff in Irish PPP schools having their pension rights restricted and changes made to their expected pay awards and overtime payments. As one caretaker stated: “They want to cut down our hours and give us more work to do”;

f. *PPP advisory industry:* Throughout the nearly thirty-year history of PPPs in these islands an army of advisors and consultants has emerged that leech fees from the public purse. For example, Mott MacDonald proudly state that they have: “been ranked the number one technical advisor in the Infrastructure Journal (IJ) global league table for the seventh year. The IJ league table is acknowledged as the definitive guide to the PPP deal market worldwide.” In 2017, Mott MacDonald generated an income of over £1.5 billion, much of which comes either indirectly (via private sector partners) or directly from governments.

All these mechanisms were not evident when the PPP

policy was first implemented by John Major’s Conservatives in the early 1990s. The first sale of equity shares took place in 1998 and since then the PPP equity market has grown and was estimated to be worth £10 billion by the end of 2016. In the early years of this market the transactions mainly involved sales between existing primary private sector partners. However, from 2006 onwards specifically formed private equity funds called ‘infrastructure investment funds’ have been the major players in the market. This has resulted in a number of public assets becoming wholly owned by these investment funds, many of whom are registered in offshore tax havens. For example, by the end of 2009 Barnet General Hospital PPP project, in north London, was wholly owned by HICL investment fund, which was originally set-up by HSBC and is now registered in Guernsey.

Similarly, the refinancing of debt following the construction phase only came to prominence in the early 2000s. The early PPP contracts had no guidance on what should happen to these windfall gains, resulting in the profits being appropriated by the private sector partners. However, once the scale of the gains started to reach prominence in the media, the government negotiated a voluntary code where the public sector would receive up to 30 percent of any refinancing gains. As this regulation was voluntary there is little evidence to show that the public authorities involved have benefitted from even this small amount. The whole debt refinancing mechanism has led one group of academics to comment:

“Many PFI refinancing deals appear to have been little more than a vehicle for a direct transfer of money from the public purse to the private investors, leading some politicians to refer to refinancing as the unacceptable face of capitalism.”

These examples illustrate the dynamic and developing nature of PPP as a policy and practice but also highlights the poor and ineffectual previous attempts at regulation. Before we look at the politics of PPPs and what can be done to reverse the policy, it is necessary to understand how and why the policy and practice emerged in the first place.

PPP Emergence – neoliberalism in action

The first government to implement a PPPs policy was the UK Conservative party in 1992, however, the policy was hardly used by that government. New Labour had originally opposed the PFI/PPP policy, but by the time they

came to power in 1997 they had reversed their position and oversaw a massive expansion during the subsequent governments up to 2010.

The early years of PFI/PPP were accompanied by a great fanfare of how this innovative policy would provide value for money (VfM) for the taxpayer, unlock private sector management expertise, avoid adding to the national debt, engender a long-term partnership between private sector providers and public authorities., The problem for advocates of PPPs is that all the justifications have been shown to lack substance or simply be wrong, in theory and/or practice. For example, leaving aside the difficulties in trying to establish VfM, there have been examples showing that the calculations used to compare conventional procurement and PPP routes for individual projects have been manipulated to favour the later over the former. The off-balance sheet financing is a myth as the government needs to recognise the liability in the form of the future unitary payments; and the emergence of the PPP equity market now allows private sector partners exit after on average six years, cutting short any long term partnership.

Two researchers neatly sum-up the consensus among much of the research into PPPs, when they state:

“Most of the criteria explicitly or implicitly used by governments to justify the use of PPPs – such as deferring expenditures, placing expenditures ‘off-budget’, ‘value for money’ and ‘on time and onbudget’ – are either inadequate or just plain wrong.”

Although the above quote was published in 2012 the criticisms and mounting evidence of problems with PPPs were evident for more than a decade before then. Despite this evidence PPPs were still pursued by successive government in Britain and Ireland, often repeating the inadequate or just plain wrong claims. For example, the Parliamentary Budget Office (PBO) in Ireland produced a briefing on PPPs during 2018 stating:

“Public Private Partnerships (PPPs) are notable by virtue of the fact that they are the only off-balance sheet mechanism open to the Government that can comply with EU fiscal rules.”

This is the story that has taken hold in policy-making circles in both Dublin and London, yet the off-balance sheet mechanism claim lacks empirical substance, with examples of PPP projects being accounted for on-balance sheet. It is also instructive that EU rules are mobilised to justify the continuation of PPPs despite the research

evidence

In the rest of this article I argue that what is happening here is an example of an ideological commitment to a multifaceted neoliberal ideal. The ideological element is shown by the quote from the PBO, evading government responsibility and implying PPPs are necessary because of EU rules. The clearest example of this ideological commitment came from a previous New Labour Health Minister when he stated: “When there is a limited amount of public-sector capital available, as there is, it’s PFI or bust.” Of course the limited amount of public-sector capital is a political decision and here it is being deployed to shut down debate on alternative funding schemes for public assets.

Turning to the neoliberal ideal, PPPs emerged after a more than a decade of reforms to public services (collectively known as New Public Management) that have doctrinal components including a shift towards competition in the public sector, the breaking up of public service bureaucracies and a stress on private-sector style management techniques. These components are expressions of broader neoliberal thought, where “privatization and deregulation combined with competition, it is claimed, eliminate bureaucratic red tape, increase efficiency and productivity, improve quality, and reduce costs”. Further David Harvey states that, “the neoliberal state should favour individual private property rights, the rule of law and the institutions of freely functioning markets and free trade.”

Elements of these neoliberal ideas are clearly expressed in the design of PPPs with the transfer of facilities and services staff under TUPE arrangements and the raising of the project finance by the private sector partners as examples of privatisation; the competitive tendering process for selecting which private sector companies to carry out the construction and maintenance contracts; and, the strict contractual basis on which the PPPs are first established, and then operated, protects the property rights of the private sector partners.

Yet this is still not the end of the great wealth extractor story. The adoption of neoliberal ideals came after the shocks to the global economy in the early 1970s, when the existing dominant ideological paradigm, of Keynesianism, was shown to have no answers for capital. As Chris Harman argues, in place of Keynes, capitalists in industry and government turned to the reborn free market approaches presented by Friedman and Hayek which

seemed to offer a way out. They claimed that the economy would resolve its own problems if it were freed from “distortions” to the market—whether these came from state intervention or from trade union interference with the “flexibility” of the labour market.

Here it is important to understand that a Marxist analysis of the cause of the economic crises of the early 1970s (and indeed other economic crises) argues that it is the tendency for the rate of profit to fall (TRPF) that causes an excess of (over-accumulated) capital in the system that cannot find investment opportunities in productive ventures. Initially, this results in an investment strike by the controllers of capital, before a full recession becomes apparent.

The response to such crises, by capitalist governments, is to find ways to restore the rate of profit and thus incentivise capitalists to start investing again; this is the ultimate motivation for the PPP policy. First, PPPs allow private sector companies access to cash flows that were previously within the public sector only; second, as shown earlier, PPPs are designed to have multiple mechanisms for profit extraction to the extent that conservative, pro-market bodies such as the National Audit Office have identified examples of excessive profit-making (profiteering) from the operation of these mechanisms.

Having established the ultimate role of PPPs, we can now turn to the current politics on the policy and outline how we can bring this great wealth extractor to an end.

The politics of PPPs

The crude caricature of neoliberalism that it is just concerned with shrinking the size of the state does not stand up to the empirical evidence. A decade ago Chris Harman pointed out that: “... there is the widespread belief that neoliberalism involves a retreat of the state. This is falsified by a glance at the rate of state expenditure in the advanced capitalist countries.” This has remained the case since, with the EU average of government expenditure to Gross Domestic Product (GDP) remaining in a range between 45 – 50 per cent over the period from 2006 to 2017. Even looking at the UK, one of the leading countries for implementing neoliberal policies within Europe, over the same period government expenditure did not decline below the 40 per cent threshold, reaching a high of 47.6 percent in 2010. The idea that it is possible for an advanced capitalist economy to go back to a state the size of that in the Victorian age (i.e. with expenditure levels

in the teens or lower as a percentage of GDP) is a fanciful impossibility.

Instead the neoliberal state has become a tool to pursue the unattainable dream of free market fundamentalism, but once the private sector companies are inside the walls of the public sector they seek to use the state to embed their practices and protect their investments. For example, in 2012 seven NHS Trusts were bailed out by the British government to the amount of £1.5 billion due to onerous PPP contracts, where the unitary payment is top-sliced from the Trusts’ budget with the remainder being used for frontline services. Already noted above were the cases of hospitals in Liverpool and Birmingham where the government took over the contracts after Carillion failed. Neoliberals appear perfectly happy to use the state and public funds if it means that profits will keep flowing to private sector companies.

Yet there are limits to these activities as highlighted in the abandoned plans for co-location PPP hospitals in Ireland. Or in the case of the social housing PPP in Dublin once the developer, McNamara, went bust in 2008, the Irish government chose to let the estates concerned continue to decline sweeping the PPP failure into the broader narrative about the global financial crisis. John Bissett challenges this absolved role of the state and the lack of any underwriting for the social housing redevelopment in contrast to the government’s willingness to underwrite the losses of the banks. This is a clear example of the class interests that run through PPP projects – social housing need is ignored and frontline hospital services are cut but payments to the private sector contractor is guaranteed.

The impact of the collapses of McNamara and Carillion brings us to the political difficulties that can arise for parties that support PPPs. In a dramatic, if not unsurprising, reversal the UK’s Chancellor, Philip Hammond, announced last October that he will not sign any new PPP contracts while in office. The party that had introduced the policy nearly three decades ago has now ditched it. In a piece of classic politicking that could have been scripted by the writers of *Yes Minister*, Hammond blamed the previous New Labour governments and went on to say:

“I remain committed to the use of public-private partnership where it delivers value for the taxpayer and genuinely transfers risk to the private sector. But there is compelling evidence that the private finance initiative does neither. The days of the public sector being a pushover must end.”

Hammond's announcement follows the declaration the previous year at the Labour Party conference in 2017 by the Shadow Chancellor, John McDonnell, that a future labour government would also not sign any new PPP contracts and that the existing PPP projects would be brought back in-house, into the public sector. McDonnell's announcement has sparked an at times technical debate about how the PPP contracts will actually be brought back in house. In part this is due to the complex structure using SPVs as explained earlier, but it also reflects a large political disagreement.

In broad terms there are those who advocate 'work around' policies, essentially leaving the PPP structures in place, and those who seek to challenge the policy head-on. An example of the first, are those who advocate a one-off windfall tax on profits being made by the SPVs, in line with the reduction of the UK corporation tax rate from 30 to 18 percent in recent years. This approach is supported by Blairite Labour MPs, such as Stella Creasy.

In contrast, John McDonnell's PPP advisor, Helen Mercer, has produced a report, along with independent researcher Dexter Whitfield, that argues for nationalisation of the SPVs. Securing the share capital in the SPVs, whether with or without compensation, is only a first step to ending PPPs. This step would close out any wealth extraction via the equity sales. However, as outlined earlier there are multiple mechanisms in the great wealth extractor and each mechanism needs to be dismantled. Mercer and Whitfield outline the other necessary steps which include renegotiating the facilities management contracts and refinancing the debt. The former is to avoid keeping outsourcing in place and the latter would allow for the SPVs to access finance at the same interest rate as the government (i.e. at the lowest possible cost).

Meanwhile, in Ireland, despite all the evidence available to policymakers from the experience across the water and the recent abandonment (to varying degrees) of PPPs by both the Labour and Conservative parties, the Irish government remains committed to using PPPs. In July 2018 a government review into the future use of PPPs in Ireland, prompted by the collapse of Carillion, concluded that: "...PPP's should remain a feature – broadly to the same extent as heretofore – in overall public capital investment."

Conclusion: campaigning makes the difference

In this article I have tried to show how PPPs are a clear expression of the priorities of capitalism over the past half century. PPPs are complex in structure, with multiple mechanism designed to extract the maximum amount of wealth possible for private sector companies from the provision of public services. In this respect they are part of the overall policy responses adopted by governments to the crisis of profitability that shook capitalism in the 1970s.

The past 18 months has seen the two major parties in Britain, the cradle of PPPs, both abandon the policy. It would be a mistake to interpret this as PPPs collapsing under their own costly contradictions with the public sector having to step in when projects fail. In reality there has been long-term opposition to PPPs from trade unions and campaign groups in Britain. This has been added to by academics and journalists who have been willing to move beyond the bluff of PPP advocates and investigate the real impact of using private finance to provide public services and then going on to publicise their findings.

This campaigning has created a hostile environment towards PPPs, where even the dogs in the street know that they are a rip-off. If such campaigns had not taken place, PPPs would still be continuing in Britain, as they are in Ireland. It is not that the Irish PPP schemes are somehow more appropriate or better constructed, it is simply that there has not been the same level of opposition on this side of the Irish Sea.

However, with the Irish government showing no sign of moving away from using PPP for large public infrastructure projects there will be opportunities in the future to campaign and confront directly this great wealth extraction mechanism. The difficulty with campaigning against PPPs is the often abstract nature of the issues and a lack of direct, immediate impact on workers' and communities' day to day experience. At a time when issues like the housing crisis demand a huge response from socialists, setting aside time and resources to campaign against PPPs is a significantly lower political priority but one which, thanks to the successes in Britain, we now have a blueprint to inspire those future campaigns.