Financing Infrastructure in the 21st Century

The Long Term Impact of Public Private Partnerships in Britain and Australia

Dexter Whitfield

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List of Abbreviations

ALMO	Arms length Management Organisation
BSA	Building Services Association
BSF	Building Schools for the Future
CBI	Confederation of British Industry
CSR	Corporate Social Responsibility
DBFO	Design, Build, Finance and Operate
DCLG	Department for Communities and Local Government
DfES	Department for Education and Skills
DH	Department of Health
DSO	Direct Service Organisation
DWP	Department for Work and Pensions
EIB	European Investment Bank
EU	European Union
FM	Facilities Management
GATS	General Agreement for Trade in Services
ICT	Information and Communications Technology
IMF	International Monetary Fund
JVC	Joint Venture Company
LEA	Local Education Authority
LEP	Local Education Partnership
LIFT	Local Improvement Finance Trust
LSP	Local Strategic Partnership
MBC	Metropolitan Borough Council
NAO	National Audit Office
NHS	National Health Service
NSW	New South Wales
NOMS	National offender Management Service
OBC	Outline Business Case
ODPM	Office of the Deputy Prime Minister
OECD	Organisation for Economic Co-operation and Development
OGC	Office of Government Commerce
OJEU	Official Journal of the European Union
PbR	Payment by Results
PCT	Primary Care Trust
PFI	Private Finance Initiative
PfH	Partnerships for Health
PfS	Partnerships for Schools

PPP	Public Private Partnership
PSC	Public Sector Comparator
PwC	PricewaterhouseCoopers
RCE	Regional Centre of Excellence
SMIF	Secondary Market Infrastructure Fund
SPV	Special Purpose Vehicle
SSP	Strategic Service-delivery Partnership
STEPS	Strategic Transfer of the Estate to the Private Sector
TUPE	Transfer of Undertakings (Protection of Employment) Regulations 1981
VFM	Value For Money
WTO	World Trade Organisation

Executive summary

The Private Finance Initiative/Public Private Partnership (PPP/PFI) debate is locked into technical issues about financing, on/off balance sheet accountancy, risk allocation, efficiency, narrow value for money matters and the procurement process.

This report draws together the recent experience, trends and developments of PPP/PFIs and Strategic Service-delivery Partnerships (SSPs) in Britain and the development of PPPs in Australia. The objective is to generate a wider debate on the longer-term issues of accountability, sustainability, the future of public services, the role of government and the provision of the social and economic infrastructure.

The early PPP/PFI projects were usually major transport infrastructure schemes in the late 1980s and early 1990s. However, PPP/PFI was soon extended to other types of infrastructure such as schools, hospitals, prisons and courts. A number of ambitious ICT projects were developed in the mid 1990s but after a series of long delays, cost overruns and service failures, ICT projects were excluded from the PPP/PFI programme. The introduction of the National Health Service (NHS) Local Improvement Finance Trusts (LIFT) and Building Schools for the Future (BSF) models further embed private finance and private provision within the public sector.

None of the reforms of PPP/PFI such as reducing the scope of facilities management contracts, seconding rather than transferring staff, making the procurement process more participative, increasing community benefits obtained in the procurement process and limiting the scope and powers of Special Purpose Vehicles (SPVs) or Joint Venture Companies (JVCs) have little bearing on the critique of PPP/PFI and the analysis of its long-term impact. Radical reform of risk transfer and value for money criteria would mean that most PPP/PFI projects never proceed beyond the options appraisal stage.

A four-part typology of privatisation and marketisation provides a framework to explain and understand the different ways in which public services and the welfare state are being transformed. The different forms of marketisation are part of a broader restructuring of the state in the interests of capital.

In Britain, 750 PPP/PFI deals have been signed with a total capital value of A$130 billion (£48.4 billion) up to March 2006 (see Table 4). A further 200 projects requiring A$65 billion (£26 billion) capital investment are expected to be signed in the next five years. By 2010/11, the total capital value of PPP/PFI projects is forecast to be A$195 billion (£75 billion). In addition, 22 Strategic Service-delivery Projects, centred on ICT and the transformation of corporate services (valued at over A$8billion (£3bn) and employing 10,000 staff) have been established in Britain since 2000 with a further four in procurement. However, two SSP projects have been terminated and a third substantially reduced.

Nearly forty-five PPP projects have been signed in Australia with a further 18 projects in procurement according to the National PPP Forum database.

There are some important differences between PPP/PFI projects in Britain and Australia. In Britain, the scale and scope of projects are larger and there is a much wider range of projects with a more extensive role in the welfare state and social infrastructure. There is also much stronger employment legislation to protect jobs, terms and conditions compared to further deregulation of employment in Australia. New PPP/PFI models in health and education provide opportunities to include core services in PPP/PFI projects in Britain. New markets have emerged in Britain for refinancing of project debt and PPP/PFI equity disposals (contractors wanting to realise profits and recycle capital into new projects).

In order to assess the extent to which the longer term impact of PPP/PFI has been considered in policy and research reports, a sample of 25 studies were examined from Global/European, British and Australian sources. They are divided into three groups - government policy and evaluation reports, consultants and business reports, and academic/policy studies.

Long-term impact

Internal changes in PPP/PFI projects include new PPP/PFI models, the inclusion of core services in education and health, the potential rationalisation of projects in cities/regions and the impact at completion of the contract. They have all contributed to the consolidation of PPP/PFI and SSPs in public policy.

The external drivers include:

- Growth of refinancing of projects and secondary market in sale of equity stakes in consortia.
- Increasing influence of the PPP/PFI business lobby.
- Restructuring of local government with focus on commissioning and withdrawal from service provision.
- Public sector capital expenditure limits in the Comprehensive Spending Review 2006/07 – 2008/09.
- Marketisation of public services by competition, contestability and choice imposed through market mechanisms.
- Corporatisation of public management through public sector shareholding and directorships in private companies operating within public services.
- Liberalisation of services via the European Union Services Directive and the planned WTO General Agreement for Trade in Services (GATS).

The long-term impact of PPP/PFI includes:

- Financial impact of off-balance sheet and affordability issues affecting other services.
- Further erosion of democratic accountability and transparency.
- Reduced capacity of public sector and knowledge transfer.
- Commercialising community use of schools.
- Decline of in-house public sector service delivery organisations and transfer to the private sector.
- Decline in public sector employment.
- Loss of benefit of local production and supply chains in the local/regional economy.
- Bigger private sector role in regeneration and management of public sector assets.
- Growth of a corporate welfare complex as a result of the expansion of a contracting culture and emergence of a owner/operator infrastructure industry.

Government rationale for PPP/PFI

The Government's approach to PFI is claimed to consist of an objective assessment of value for money (which must not be at the expense of employee terms and conditions), no bias between procurement options and consistency with the Government's wider public sector reform agenda.

PPP/PFI projects have a central role in the government's neoliberal modernisation strategy. They support and promote the key elements of neoliberalism - liberalisation and competition, markets, deregulation of financial markets, Reconfiguring the role of the state, privatisation, consumerism, labour market flexibility and deregulation and Increasing power of business in public policy making.

Refinancing

Once an infrastructure project is built and operational, the project risks (such as delays in construction and site difficulties) are no longer relevant. Financial institutions are prepared to refinance projects offering better terms to reflect the lower risks (National Audit Office, 2002).

Refinancing 12 private finance initiative projects between 1999-2005 resulted in a A$356m (£142.6m) gain for private finance initiative consortia, compared to A$68m (£27.3m) for the public sector (National Audit Office 2000, 2002, 2004, and 2005). Refinancing enables the private sector to increase the profitability of the private finance initiative over and above the average 14.5% rate of return which is built into projects before refinancing. Refinancing has resulted in PPP/PFI consortia increasing the level of borrowing to make earlier dividend payments and increase the length of some contracts. This has increased termination liabilities for the public sector thus further reducing flexibility.

Several dedicated secondary market investments funds have been set up to acquire PPP/PFI equity. These funds are planning to build a portfolio of projects. Ownership of prisons, schools and hospitals will transfer from construction company-led consortia to financial investment trusts which will want to increase returns by reducing operational costs by rationalising asset management.

PPP/PFI performance

The failure and poor performance of some PPP/PFI projects falls into four groups – structural failure, the financial collapse of or crises in construction companies, poor design and poor facilities management services. The government has admitted that PPP/PFI has not led to a step change in the performance of facilities management services.

The report examines five PPP/PFI projects – the Skye Bridge, Scotland contract (which was terminated to abolish tolls), the National Physical Laboratory (contract terminated), the Paddington Basin project (project abandoned before procurement commenced), the Royal Armouries, Leeds (PFI contract terminated) and the refinancing of National Air Traffic Services.

Erosion of democratic accountability

PPP/PFI has resulted in the erosion of democratic accountability. User/community organisation and staff/trade union consultation and involvement in the planning, business case and procurement processes is normally very limited. 'Commercial confidentiality' makes comparisons between public and private sector performance almost impossible and meaningless because the precise quality and level of service, staffing levels, pay and conditions and other factors which determine performance is more difficult to obtain from privately operated contracts.

In addition, the technical nature and complexity of projects imposes constraints on participation – finance, legal, technical – which means that many people are excluded. It leads to consultants and advisers having a very influential role with very little accountability and scrutiny.

BSF, LIFT and SSP projects place private sector corporate interests in the heart of local government and other public bodies. This is done in the name of 'partnership' but with virtually no debate about the effect on democratic accountability, political processes or the longer term consequences of a multiplicity of boards with business representation within local government and other public bodies.

Employment impact

The full employment impact of PPP/PFI projects is difficult to identify because the labour content varies very widely between projects. However, it is estimated that between 150,000 and 450,000 staff have been transferred from the public to the private sector in Britain plus a further 9,000 either seconded or transferred in SSP projects.

There are basically four employment options or models for PPP/PFI and SSP projects:

- In-house – staff remain public sector employees.
- Secondment – staff remain public sector employees but are managed by a private or voluntary sector provider on a day-to-day basis.
- Outsourcing or contracting out – staff are transferred to a private or voluntary sector employer.

- A choice or mixed economy model in some SSP projects has a combination of seconded and transferred staff.

The transfer of undertaking regulations (TUPE – which implement the European Union 1977 Acquired Rights Directive in Britain) and the Best Value Code of Practice on Workforce Matters in Local Government are important regulations which afford a degree of protection for jobs, terms and conditions in Britain (ODPM, 2003).

The Best Value Code of Practice now applies to all public sector bodies. The Code requires contractors (and sub-contractors) to employ new staff working alongside transferred staff on "fair and reasonable terms and conditions which are overall no less favourable than those of transferred employees" (ibid). Contractors must consult with trade unions to agree the terms and conditions for new starters. The Code must be included in the contract between the public body and the contractor.

There is no comparable transfer and employment rights in Australia.

The trade union twin-track strategy in Britain has consisted of opposing PPP/PFI projects by national and local campaigning to expose the high financial, employment and democratic costs combined with local negotiating to secure the best possible deal for members on individual projects. However, this strategy has not achieved any significant changes in PPP/PFI because it failed to organise and mobilise opposition and relied almost exclusively on technical evidence (Whitfield, forthcoming).

PPP/PFI is a high cost strategy

There is compelling and mounting evidence that PPP/PFI does not achieve the claimed value for money. Options appraisal and Outline Business Cases are often contrived because capital spending controls mean that PPP/PFI is the only option available.

Public investment options

Changes to fiscal policy framework: Britain and Australia have different fiscal policy frameworks and public sector net debt as a percentage of national income is close to 40% in Britain (the sustainable investment rule) but 0% in Australia in 2005. In both cases there is obvious reluctance to change fiscal farmeworks. However, the thesis of this report is that the long-term consequences of continuing and expanding PPP/PFI are such that they warrant the re-examination and adjustment of fiscal frameworks to increase public investment.

Infrastructure bonds: There are wide differences between countries in the way that infrastructure is funded. Infrastructure bonds are commonly used in the US, whereas in Britain and Australia there is a reluctance to hypothecate revenue to allocate specific tax revenue for specific purposes, for example, fuel taxes to fund motorways.

Changing public spending priorities: The cost of the marketisation of public services in Britain is estimated to be A$20 billion (£8 billion)) in one-off capital and revenue costs to date plus over A$7.5 billion (£3 billion) annual costs (Whitfield, 2006). These costs include subsidies, debt write-offs, capital spending and the revenue costs of 'making markets'. A large part of these resources could be available for additional capital investment and associated revenue expenditure.

The combined use of prudential borrowing - good performing public bodies are allowed to increase investment based on their ability to meet loan charges, government programme grants, savings from Business Process Reengineering, the use of reserves to pump prime initial investment and capital investment programmes has enabled some local authorities to restructure services in-house and procure 'best in class' ICT advice, hardware and software as an alternative to the SSP model.

More than public investment

It is clear that simply increasing public investment alone is not a sustainable strategy. It must be accompanied by a series of changes in public policy which improve project management, procurement and increase the authority's control over capital investment.

- Increase public sector capacity to plan, design, manage and supervise projects.

- Introduce rigorous impact assessment in project planning, options appraisal and evaluation.
- Strengthen contract management and monitoring arrangements so greater pressure is imposed on private contractors to deliver on time and to budget.
- Strengthen public sector management and control of the procurement process.
- Adopt whole life costing and planning of facilities management for all projects.
- Develop integrated and coordinated delivery of in-house FM services.
- Require public sector gains from refinancing remaining PPP/PFI projects be channelled into the finance of infrastructure projects.

Alternative to neoliberal modernisation

The debate about the future of PPP/PFI must be part of a wider discussion to develop an alternative modernisation strategy to neoliberalism. It should have a number of central themes including the restatement of public service principles and values to be embedded in all policies, programmes and projects; democratic accountability and transparency including a revitalisation and empowerment of local government; the integration of strategic policy making and service provision with the abolition of the commissioning/outsourcing agenda; the mainstreaming of equalities, social justice and sustainable development; and quality employment with a better skilled and trained workforce with good quality pensions.

Key conclusions

The case against the use of PPP/PFI other than for very large infrastructure projects can be summarised as:

The financial case

- It does not bring additional private sector investment because the cost of PPP/PFI is ultimately entirely funded by the public sector.
- Higher cost of private sector borrowing – private finance adds between 1% - 3% to the cost of borrowing.
- High transaction costs including consultants and advisers, financial arrangement fees, project management and procurement costs.
- Escalating total project costs, the difference between the Outline and Final Business Case costs is very often substantial.
- Affordability and the financial impact on budgets, which may have to be cut to accommodate PPP/PFI payments, could have a negative knock-on effect on other services.
- High cost of early termination of contracts.
- Off balance sheet finance could store up future problems and intergenerational liabilities.

The democratic case

- Erosion of democratic accountability and transparency.
- Limited stakeholder involvement because of technical complexity, 'commercial confidentiality' and reluctance of PPP/PFI consortia and consultants to engage in meaningful dialogue.
- The fallacy of long-term partnerships when contractors and financial institutions may sell equity stakes and the public sector is powerless to stop new partners taking over with different interests.

The planning case

- Misallocation of risk - transfer of risk is frequently overstated and over-priced.

- Justified on narrow value for money criteria.
- Future improved private sector performance is compared with historic public sector performance undertaken by the same or similar companies.
- Lack of flexibility to meet changing social needs because public bodies are tied into long term contracts.
- Access to private sector expertise can be obtained more cost effectively through other procurement methods.
- Contributes to the marketisation of public services and widens the role of the private sector in the public policy making process.
- Long and costly procurement process.
- The private sector will have increasing control over the provision of the ‘public’ infrastructure.
- Core services will increasingly be included in the scope of PPP/PFI projects.

Recommendations

1) All planned PPP/PFI and SSP projects should be terminated.
2) Social and welfare state infrastructure must be financed by public investment.
3) Fiscal frameworks in Britain and Australia should be adjusted to increase national/regional and local public sector capital investment in infrastructure projects.
4) New methods of public funding of infrastructure such as infrastructure bonds should be investigated.
5) The public sector must develop whole life planning and costing for all infrastructure projects.
6) The public sector should draw up an infrastructure capacity building programme to retain and extend intellectual knowledge to improve project management, technical and corporate skills and reduce reliance on external consultants. All contracts with consultants must have knowledge transfer to the public sector and capacity building clauses.
7) Public-public or shared services projects should be developed within the public sector drawing on ‘best in class’ technical advice and ICT hardware/software as and when needed.
8) Options appraisals, Outline Business Cases, contract/partnership agreements and reports and minutes of Partnership Boards should be made available for public inspection. Whilst some degree of commercial confidentiality is essential this can be protected with maximum rather than minimum disclosure.
9) An alternative modernisation strategy is essential to reclaim public service principles, re-establish democratic accountability and mainstream social justice, sustainable development and quality employment.

Part 1
Introduction and overview

The Private Finance Initiative/Public Private Partnership (PPP/PFI) debate is locked into technical issues about financing, on/off balance sheet accountancy, risk allocation, efficiency, narrow value for money matters and the procurement process. Participants and advocates are increasingly locked in a silo mentality focussed on detailed project mechanisms and oblivious of the wider and longer term policy implications.

This report draws together recent experience, trends and developments of PPP/PFIs and Strategic Service-delivery Partnerships (SSPs) in Britain and the development of PPPs in Australia. The objective is to generate a wider debate on the longer-term issues of accountability, sustainability, the future of public services, the role of government and the provision of the social and economic infrastructure.

Objectives

The objectives of the paper are to:

- Identify the longer-term implications for public services by continuing with PPP/PFI.
- Examine recent developments in policy and practice in Britain and examine how new PPP/PFI models in education and health could further embed neoliberal policies.
- Identify the main cost, evaluation, design, quality of service, accountability and other problems of PPP/PFI projects.
- Promote the advantages of direct public sector investment in infrastructure.
- Compare UK and Australian experience, trends and developments drawing out the lessons to be learnt.

Methodology

The literature review covers UK, European, Australian, OECD and other relevant studies. It also draws on European Services Strategy Unit (Centre for Public Services) work on PPP/PFIs and SSPs in the past decade.

Infrastructure

There are eight basic types of infrastructure:

- Transport infrastructure consisting of rail, light rail, roads and bridges, airports and air traffic control, ports, canals.
- Welfare state facilities – schools, hospitals, health centres, green spaces, recreational and leisure facilities, plus a social infrastructure consisting of community centres, meeting places, activity centres, adult training and life long learning centres.
- Utilities including water and sewage, dams, energy (electricity, gas and oil).
- Environmental - waste disposal and recycling.
- Information and communications technology infrastructure including telephone, internet, TV, radio and postal services.
- Arts and cultural – galleries, museums, music venues, libraries, arts centres.
- Democratic and public administration infrastructure including town halls and civic centres, offices for government departments, agencies and other public buildings.
- Defence equipment and training.

Definition of PPP/PFIs

Public Private Partnership (PPP) is a generic term used to describe privately financed projects and partnerships to design, build, finance and operate facilities.

Public Finance Initiative (PFI) is a programme in Britain in which the private sector designs, builds, finances and operates (DBFO) new or refurbished infrastructure and facilities.

PPP/PFI projects are described as partnerships but are in fact governed by long-term contracts. There are other PPP models and variants such as Build-Own-Operate-Transfer (BOOT) but this report focuses on the standard DBFO model (IMF, 2004).

Strategic Service-delivery Partnerships (SSPs) are usually based on information and communication technology (ICT) and related corporate services such as financial and legal services, human resources, property management and customer services centres, often referred to 'back office services'. A false distinction is often made between back office and frontline services. Contracts are usually for 10-15 years compared to 25-35 years or longer for PPP/PFI contracts. They are also financed through public sector revenue budgets with the private sector sometimes front-loading investment.

There are also examples of strategic partnerships between local authorities and private contractors for the management and operation of Works Departments of Direct Service Organisations (for example, Sheffield City Council and Kier Holdings). Similar large multi-million pound partnerships for highways and street services are planned (for example, Birmingham City Council).

PPP/PFI projects are categorised into different classes of infrastructure assets for the purposes and interests of private investment. Long-Term Accommodation contracts to provide buildings for public services such as education, health, criminal justice system, social care and other public buildings are considered relatively low risk because they are funded by the state. User Revenue projects, such as toll roads, rely on user charges as the main source of revenue. A third type of asset, such as electricity and gas transmission and distribution and water and sewage, operate in regulated frameworks which determine revenue and charges. Finally, some infrastructure assets, such as electricity and gas generation, operate in competitive markets and are thus more exposed to market risks.

Development of PPP/PFI

PPP/PFI projects in the late 1980s and early 1990s were usually major transport infrastructure schemes. However, PPP/PFI was soon extended to other types of infrastructure such as schools, hospitals, prisons and courts. A number of ambitious ICT projects were developed in the mid 1990s but after a series of long delays, cost overruns and service failures, ICT projects were excluded from the PPP/PFI programme from July 2003. PPP/PFI is being widely used by the Ministry of Defence with over A$12.5 billion (£5 billion) capital expenditure approved to date with several large schemes at the planning/procurement stage. The introduction of the NHS LIFT and BSF models further embed private finance and private provision within the public sector.

The LIFT programme to renew primary health care facilities was announced in the NHS Plan 2000. There are now 51 projects in four waves accounting for £1 billion of capital expenditure. A joint venture company is established with the private sector having a 60% share stake with Partnerships for Health (a Department for Health quangos) and the local Primary Care Trust (with local authority and other local stakeholders) each having a 20% stake. The LIFT company rents premises to doctors, pharmacies and other health organisations and retains ownership of the assets after the 20-year agreement expires. It has an exclusivity agreement to undertake the provision of additional facilities during the contract period.

The early LIFT projects did not include facilities management services but later projects did and fourth wave projects may include some clinical services (see chapter 2). LIFT projects do not require a Public Sector Comparator. The model originated because of the high cost of new health facilities in inner city areas. Access to capital was not the central issue as many surgeries were already privately owned by GPs. However, the rents in some LIFT projects are up to eight times current rent levels (House of Commons PAC, 2006).

Building Schools for the Future (BSF) is the government's new £40 billion PPP/PFI programme to renew the secondary school infrastructure in England over the next fifteen years. A Local Education Partnership (LEP), 80% controlled by the private sector, with the local authority and Partnership for Schools (a new Department for Education and Skills quango) each have a 10% stake, is at the core of each Building Schools for the Future project.

The Local Education Partnership (LEP) will design, build, finance and operate new and refurbished schools using a mix of public and private investment. But Building Schools for the Future is not just about the provision of new schools. The local education authority must fully review its educational vision, develop a strategy for educational provision which integrates the building programme with service delivery, a new information and communications technology infrastructure, teaching, school management and community use. The government's controversial Academy schools programme is now part of the BSF programme. Academies are privately-run schools sponsored by business people, companies, faith groups and trusts which provide 10% of the capital costs with the government funding the rest. Academies employ their own staff and appoint a majority of governors.

The government wants local authorities to become commissioning organisations rather than be a provider educational services. So the LEP will not only deliver facilities management services but could also provide educational support services, special educational needs, school transport and other services.

The government intends to develop new PPP/PFI models.

> *Strategic partner*ships: The LIFT and BSF models are variations of a joint venture approach between the public and private sectors with a long-term strategic relationship. It regards these models as still being in the "early stage of development" (HM Treasury, 2006a).
>
> *Project delivery organisation model:* The government is looking to a new model emerging in the Military Flying Training System (MFTS) project in which the private sector will deliver training from student entry to aircrew selection and to operational status.
>
> "*Unlike an individual project, the project delivery organisation will manage the procurement of the underlying assets and then integrate those assets together with necessary component services to provide an overall service to the procuring authority. This may be beneficial in projects where there is a long construction period or where the service requires significant investment in new capital assets during the life of the contract or where there is a significant likelihood of material change in requirements throughout the life of the deal. This means that PFI investment can be managed alongside other forms of investment which are not suitable for PFI while still achieving improvements in service delivery"* (ibid).

This model is claimed to have advantages because the private sector is engaged at an early stage in the project, it attempts to reduce the length of the procurement process by requiring the the private sector to provide procurement delivery and management skills. It could have far reaching consequences for the public sector.

The PPP/PFI sector is increasingly concerned about the potential impact of the marketisation of public services such as health and education. Basically they are worried that patients and pupils may choose not to attend PPP/PFI hospitals and schools. This is creating 'uncertainties' and hence the demand for 'demand risk' in PPP/PFI projects to be retained by the public sector. They want a more selective transfer of risk (Deloitte, 2006). It is also claimed that the LIFT and BSF models are "not sufficient to meet the public sector's infrastructure needs" because a lack of competitive pressures raises concerns about whether value for money is obtained and the previous "conditions of relative certainty" are changing because of marketisation (ibid).

A shift to delivering upgrades rather than new build and some PPP/PFI projects in technology and waste face "considerable future risks and uncertainties and the LIFT/BSF models are either untested or unsuitable in the circumstances (ibid). Hence 'competitive partnership', 'integrator' and 'incremental partnership' models as further variants of the PPP/PFI may emerge.

A text adopted by the European Parliament in October 2006 claimed that "PPPs are not a first step towards the privatisation of public tasks" and called to PPP/PFI projects at European level, for example to implement the trans-European transport networks (European Parliament, 2006). It referred to PPP/PFI as an "alternative to privatisation in times of scarce budgetary funding and help public administrations to modernise by acquiring know-how from the private sector". It also called on Member States to "create transparent mechanisms guaranteeing that private investor's legal and financial interests are protected during the whole lifetime of a contract" (ibid).

Radical reform of PPP/PFIs?

Local trade union strategies have sought to reform PPP/PFI and have in some cases succeeded in:

- Reducing the scope of facilities management contracts by excluding facilities management services.
- Reducing the employment impact by seconding rather than transferring staff.
- Making the procurement process more participative by increasing stakeholder involvement.
- Increasing community benefits obtained from the consortia in the procurement process.
- Limiting the scope and powers of Special Purpose Vehicles (SPVs) or Joint Venture Companies (JVCs).

Important as these concessions may be locally, they have little bearing on the critique of PPP/PFI, and more particularly, the analysis of its long-term impact. Radical reform of risk transfer and value for money criteria would mean that most PPP/PFI projects never proceed beyond the options appraisal stage.

Development stages

There have been a series of phases in the development of PPP/PFIs in Britain in the last 20 years (see Table 1).

Table 1: **Development phases of PPP/PFI**

Phase	Type of infrastructure	Partnership models and involvement of the private sector
Phase 1	Major transport – roads and bridges	Design, build, finance and operate and shadow toll road model
Phase 2	Criminal justice such as prisons and courts	Prison accommodation model
Phase 3	Social infrastructure such as hospitals and schools	Grouping of schemes such as schools and primary health care facilities
Phase 4	ICT projects	Excluded from ICT after series of delays and cost overruns.
Phase 5	Defence	Large scale military equipment and training.
Phase 6	Extension into grouped schemes, wider range of services.	Development of new models such as NHS Local Improvement Finance Trust and Building Schools for the Future. Establishment of private company within public sector.
Future phases		

Phase 7	Potential widening inclusion of core services	Possible development of managed services and asset/property management models. Private sector could manage both PPP/PFI and public sector investment as in BSF model.

Locating PPP/PFI in a typology of privatisation and marketisation

A typology of privatisation and marketisation is essential. There are many partial analyses of privatisation produced by academics and development agencies and there are attempts to redefine and narrow privatisation, for example claiming that it is applicable only to share flotations, to try to minimise opposition. Others focus almost exclusively on the liberalisation of public services and privatisation imposed by the European Union (Services Directive) and the World Trade Organisation (GATS). Whilst these policies will have a crucial impact, many other forms of privatisation such as PPPs are virtually unchallenged in many countries.

Furthermore, it is important to fully understand the increasingly central role that privatisation and marketisation have in public service modernisation and the neoliberal dominated public policy making process. A typology facilitates a better understanding of the ways in which different forms of privatisation and marketisation interact. In particular, it is essential to capture changes in gender, social and class relations as well as different economic forms of privatisation. A mere mechanistic approach, based on forms of private ownership and asset transfer processes between public and private sectors, would be limited in its usefulness.

The typology of marketisation and privatisation also provides a framework to explain and understand the different ways in which public services and the welfare state are being transformed (Whitfield, 2006 and ESSU, 2006). The different forms of marketisation are part of a broader restructuring of the state in the interests of capital. PPP/PFI does not operate in isolation. It extends privatisation of the infrastructure and the scope of PPP/PFI projects is in turn influenced by outsourcing, the creation of competitive markets, the transfer of services to arms length companies and trusts and the privatisation of public sector intellectual knowledge.

There are four types of marketisation and privatisation – the marketisation of global public goods, the marketisation and privatisation of assets and services, the privatisation of governance and democracy and the privatisation of the public domain. They are described in Table 2.

Table 2: **PPP/PFI in the typology of privatisation and marketisation**

Typology of Privatisation and Marketisation
Marketisation and privatisation of global public goods (examples)
Carbon market in response to climate change
Deregulation of protection of natural resources and the global commons
Public health
Privatisation of global governance
Rise of privatised military industry
Marketisation and privatisation of assets and services
Commissioning of public services from private and voluntary sectors
Marketisation and expansion of private services, including franchising of services to the private and

voluntary sectors
Private finance of infrastructure and services with PPP/PFI
Choice and personalisation of social need
Deregulation, liberalisation and re-regulation
Commercialisation of the public sector
Sale of assets to private sector through share flotations and trade sales
Sale and leaseback of government buildings
Asset based welfare state
Increase domestic & family responsibility
Privatisation of governance and democracy
Contract governance
Transfer of services to arms length companies and corporatisation of quasi-public bodies
Private companies established within public services
Privatisation of development and regeneration responsibilities
Privatisation of citizenship and political power
Privatisation of public interest information – reduced transparency and disclosure
Privatisation of the public domain
Public service values and principles being replaced by market ideology and commercial values
Privatisation of public intellectual capital
Privatisation of public space and domain

Source: New Labour's Attack on Public Services, Dexter Whitfield, Spokesman Books, Nottingham, 2006.

Global public private partnership market

Some US$260 billion has been invested globally, mainly Europe, Australia and Canada, by the private sector in public private partnerships between January 1994 and September 2005 (PwC, 2005). Projects in Europe in this period were valued at one billion Euros, with the United Kingdom accounting for two thirds of deals, and Spain and Portugal accounting for 9% - 10% each.

Telecoms accounted for nearly 50% of public private partnerships in low and medium income economies in the 1990-2005 period, according to the World Bank's public private partnerships database – see Table 3. Telecoms accounted for half of the total public private investment investment, energy projects accounted for about a third, followed by transport with 15%, and water/sewage projects a mere 5%.

Table 3: **Public private partnership investment in developing countries by region 1990-2005** (US$billion)

Region	Energy	Telecom	Transport	Water/ sewage	Total
Europe* & Central Asia	38.3	125.7	13.6	4.1	181.7
East Asia & Pacific	86.5	64.8	49.0	23.6	223.9
Latin America & Caribbean	132.3	194.6	67.1	22.0	416.0
Middle East & North Africa	15.1	23.3	2.1	0.7	41.2
South Asia	26.2	38.2	6.1	0.0	70.5
Sub-Saharan Africa	7.1	25.3	3.4	0.1	35.9
Total	**305.5**	**471.9**	**141.3**	**50.5**	**969.2**

Source: World Bank Private Participation in Infrastructure Database, September 2006.
* Low and middle income countries only

In Britain, 750 PPP/PFI deals have been signed up to March 2006 with a total capital value of £48.4 billion (see Table 4). A further 200 projects, requiring £26 billion capital investment, are expected to be signed in the next five years. Thus by 2010/11 the total capital value of PPP/PFI projects is forecast to be £75 billion.

Table 4**: PPP/PFI Signed Deals in UK,** March 2006 (HM Treasury)

Department	No of Projects	Total Capital Value (£m)
Cabinet Office	2	347.7
Crown Prosecution Service	1	26.0
Dept for Constitutional Affairs	14	371.4
Dept for Culture, Media and Sports	13	212.1
Dept for Environment, Food & Rural Affairs	14	650.9
Dept for Transport	51	21,955.6
Department for Education and Skills	144	4,111.9
Dept of Health	149	6,572.0
Dept of Trade and Industry	8	180.8
Department for Work and Pensions	11	1,341.0
Foreign and Commonwealth Office	2	91.0
HM Treasury	2	189.0
Home Office	42	1,186.8
Ministry of Defence	55	4,570.5
Northern Ireland	39	709.4
Office of the Deputy Prime Minister	65	1,110.7
Scotland	91	2,745.4
Wales	33	555.0

Office of Government Commerce	1	10.0
HM Revenue and Customs	10	624.1
Total	**749**	**48,386.4**

Source: HM Treasury, 2006a

If UK wide projects and those in Wales, Scotland, Northern Ireland are excluded, 75% of the capital value of PPP/PFI projects is located in the south (see Table 5). However, if the large London Transport projects are excluded then the distribution of projects across the English regions is relatively even.

Table 5: **Regional analysis of signed PPP/PFI projects in UK**

Region	No of Projects	Capital Value £m
Eastern England	30	1,390
South East	74	2,641
London	111	22,469
South West	53	2,066
South	**(268)**	**(28,566)**
East Midlands	44	1,629
West Midlands	44	2,288
Midlands	**(88)**	**(3,917)**
North East	38	1,338
North West	51	1,801
Yorkshire and the Humber	54	1,980
North	**(143)**	**(5,119)**
Wales	39	682
Scotland	93	3,386
Northern Ireland	41	774
UK wide projects	69	5,417
Total	**749**	**48,386**

Source: HM Treasury, March 2006.

Twenty two Strategic Service-delivery Projects, centred on ICT and the transformation of corporate services, have been established in Britain since 2000 with at least a further five in procurement (see Table 6).

Table 6: **Strategic Service-delivery Partnership projects in Britain (2000-06)**

Local authority	Total value £m	No of staff	Transfer or secondment	Contractor	Services
Bath & N. Somerset	70	70	transfer	HBS Services	ICT and related
Birmingham City	N/a	450	secondment	Capita	ICT
Blackburn MBC	205	470	transfer	Capita	ICT and related
Bradford MBC	160	150	'choice'	IBM/Serco	ICT
Cumbria	140	600	transfer	Capita	Property, finance, Human resources
East Riding	N/a	600	transfer	Avarto Services	ICT and related
Edinburgh	150	n/a	transfer	BT	ICT
Essex	164	100	transfer	BT	ICT
Lincolnshire	250	1,088	transfer	HBS Services	ICT and related
Liverpool City Council	300	850	secondment/JVC	BT	ICT and related
Middlesbrough	250	1,045	transfer	HBS Services	ICT and related
Milton Keynes	200	730	transfer	HBS Services	ICT and related
Pendle	100	185	transfer	Liberata	ICT and related
Redcar & Cleveland	250	500	transfer	Liberata	ICT and related
Rochdale MBC	200	n/a	secondment/JVC	Mouchel/ Agilisys	Highways, property, design, ICT, payroll
Rotherham	N/a	550	secondment/JVC	BT	ICT and related
Salford MBC	N/a	375	secondment/JVC	Capita	Planning & property
Sheffield City Council	275	450	transfer	Liberata	ICT and related
Suffolk CC	N/a	n/a	secondment/JVC	BT	ICT and related
Swansea	100	110	transfer	CapGemini	ICT
Thurrock	427	600	transfer	Vertex	ICT and related
Westminster	240	500	transfer	Vertex	ICT and related
Total	**3,481**	**9,423**			
In Procurement					
Hammersmith		120	transfer/JVC	-	ICT
Oldham MBC	-	-	transfer	-	ICT, property management

Somerset CC	-	-	-	-	ICT and related
Swindon	-	-	-	-	ICT and related
Southampton City Council	-	-	-	-	ICT and related

Source: European Services Strategy Unit

Five local authorities commenced the SSP procurement process and were in negotiations with a preferred bidder when they decided not to proceed with the project (see Table 7). In addition, two local authorities examined the option of an SSP but decided not to commence procurement. All these authorities decided to implement ICT and transform services using in-house staff and a mixed economy approach drawing on external suppliers on a 'best in class' basis. Another authority, Newcastle City Council, commenced procurement and submitted a successful in-house bid, one of the largest-ever in-house wins in British local government.

Four SSPs have 'failed' - three have been terminated, Bedfordshire County Council, West Berkshire and the London Borough of Southwark, and the Redcar and Cleveland contract has been reduced to only a fifth of its original size.

Table 7: **Local authorities which adopted in-house option instead of an SSP**

Local authorities which retained in-house provision	
Kent County Council	Terminated preferred bidder negotiations with HBS Business Services. Established in-house improvement strategy.
Northamptonshire County Council	Withdrew during procurement process from joint partnership with Milton Keynes Council.
Newcastle City Council	Awarded £200m to in-house service and rejected rival BT bid on grounds of value for money and quality of service improvements.
Barnsley MBC	Decided not to proceed with BT bid in May 2003 because first three year payments could not be guaranteed. Risk of frontline services being cut to meet contractually-binding investment requirements.
Salford City Council	Decided against SSP approach for corporate services and did not commence procurement.
Walsall MBC	£650m project requiring transfer of 1,500 staff to Fujitsu Services abandoned in January 2006. Planned to create 750 new jobs. Council said "strong service improvements" achieved by the local authority in the past few years, felt that "it is now better placed to meet the needs of local people without the joint venture."
Wakefield MBC	Decided not to pursue a SSP after research of Liverpool, Newcastle and Middlesbrough. The former Chief Executive from Middlesbrough joined Wakefield and made the case that the market had moved on and that Middlesbrough was able to secure a 'golden deal' at the time but given Wakefield's healthy financial reserves a mixed economy approach would be more effective.
Dacorum District Council	Withdrew from preferred bidder negotiations.

Failed Strategic Service-Delivery partnerships in local government	
Bedfordshire County Council	Terminated contract with HBS Business Services in 2005 after failure to achieve key deliverables and poor performance.
West Berkshire Council	Terminated contract with Amey Group in 2005.
Redcar & Cleveland Council	Following a 'strategic review of services' HR and Payroll, Finance and Accounting, ICT, Public Access and Business support will be brought back in-house by September 2006 after only 3 years of the 10 year Liberata contract. Only 120 of 650 staff will be retained by company to continue to provide Council Tax, Revenues, Housing Benefits and Consumer Direct (Government business).
London Borough of Southwark	Education Services contract with WS Atkins terminated because of poor performance.

Source: European Services Strategy Unit

PPPs in Australia

By the end of 2005 about 45 PPP projects had been signed in Australia with a capital value of A$6.5bn (£2.8bn), representing 7% - 8% of total government infrastructure spending (Ernst and Young, 2005). A further 20 projects are in procurement according to the National PPP Forum database (see Table 8).

Table 8: **Completed and planned PPPs in Australia**

State	Projects Contracted	Projects in procurement
Government of Australia	Defence Headquarters Joint Operation Command Facility	Single Living & Environment Accommodation Precinct
New South Wales State Government	New Schools Project No 1 New Schools Project No 2 Cross City Tunnel Western City Orbital Alternative Waste Technology Facility Lane Grove Tunnel Parramatta Transport Interchange Newcastle Community Health Centre Newcastle Mater Hospital Long Bay Prison and Forensic Hospitals Chatswood Transport Interchange	Bonnrigg Living Communities Social Housing RailCorp Rolling Stock Orange-Bloomfield Hospital Redevelopment
Northern Territory State Government	Darwin City Waterfront Redevelopment Darwin Convention Centre	-
Queensland State Government	Southbank Education & training Precinct North South Bypass Tunnel	Townsville Industrial Recycling Townsville Ocean Terminal Gold Coast Marine Development

		Project
South Australia State Government	Regional Police Stations & Courts Administration Authority Facilities	-
Tasmania State Government	Risdon Prison Redevelopment	-
Victoria State Government	County Court Film and TV Studios Echuca Rochester Wastewater Treatment Plan Enviro Altona Correctional Facilities Emergency Alerting System Project Royal Women's Hospital redevelopment Melbourne Convention Centre Wodonga Wastewater Treatment Upgrade Casey Community Hospital Spencer Street Station Mobile Data Network Mobile Metropolitan Radio Eastlink Royal Melbourne Showgrounds Redevelopment Central Highlands Water-Ballarat North Water Reclamation	Baron Water-Bisolids Management Royal Children's Hospital
Western State Government	CBD Courts Complex	-

Source: National PPP Forum, Australia, 9 October 2006.

Differences in PPP/PFI between Britain and Australia

There are some important differences between PPP/PFI projects in Britain and Australia which should to be taken into account in the evaluation of projects.

- The scale and scope of projects in Britain are larger and wider.
- There is a much wider range and diversity of projects in Britain and more extensive role in the welfare state and social infrastructure.
- Although there are regional variations in PPP/PFI in Britain, there is a stronger geographic consistency compared to Australia.
- The NHS Local Improvement Finance Trust and Building Schools for the Future provide opportunities to provide core services and a wider range of additional services.
- A more extensive national PPP/PFI infrastructure in government departments in Britain compared to national and state government in Australia.
- There is much stronger employment legislation to protect jobs, terms and conditions in Britain compared to further deregulation of industrial relations in Australia.

- Multi-service Strategic Service-delivery Projects (SSPs) have developed in Britain whereas single ICT contracts are common in Australia.
- New markets have emerged in Britain for refinancing of project debt and public private partnership equity disposals (contractors wanting to realise profits and recycle capital into new projects) together with pooled secondary funds by investment trusts.
- Australian investment institutions such as Macquarie and Babcock Brown have invested heavily in PPP/PFI projects in Britain.
- There is more extensive research, investigation and audit of PPP/PFI projects in Britain than in Australia.

Part 2
Deconstructing the economic and political rationale for PPPs

Introduction

This section first sets out the British government's rationale for PPP/PFI and its fiscal framework. It then examines PPP/PFI in the context of the neoliberal agenda. It concludes with a critique of the economic case for PPP/PFI and shows how the supposed economic advantages such as risk transfer and whole-life costing mask the another agenda. PPP/PFI is not a temporary solution to alleviate a financial crisis or to plug a 'infrastructure gap or deficit' but is intended to be a permanent strategy to privatise and marketise the infrastructure to create new markets for capital accumulation.

The government's rational for PPP/PFI

The Government's approach to PPP/PFI consists of meeting four conditions:

- the choice of procurement route is based on an objective assessment of value for money;
- there is no bias between procurement options;
- value for money does not come at the expense of employee terms and conditions;
- the use of PFI is consistent with the Government's wider public sector reform agenda (HM Treasury, 2003).

The last point is important because PPP/PFI has a key role in New Labour's modernisation of public services strategy. However, the introduction of market mechanisms in service delivery is beginning to conflict with the interests of PPP/PFI projects as noted in the previous chapter.

The government believes that PFI will provide value for money when:

- There is a major capital investment programme, requiring effective management of construction and delivery and risks;
- The private sector has the expertise to deliver and "there is good reason to think it will offer value for money";
- The structure of the service allows the public sector to define its needs as service outputs that can be contracted to ensure effective, equitable and accountable delivery of public services over the contract period with risks allocated and enforced between public and private sectors;
- Assets and services are capable of being costed on a whole-life, long-term basis;
- The project is sufficiently large to ensure that procurement costs are not disproportionate;
- The technology and other aspects of the sector are stable, and not susceptible to fast-paced change;
- Assets are intended to be used over a long period;
- Robust performance incentives can be imposed on the private sector (HM Treasury, 2006a).

But none of these conditions are exclusive to the private sector. They could be accessed by the public sector through procurement methods which do not require private finance and long-term contracts.

The government recognises that PPP/PFI is unlikely to deliver value for money *"where the pre-conditions of equity and accountability in public service delivery cannot be met, as in most forms of frontline service delivery"* (HM Treasury, 2006a) or where authorities require a significant degree of short-term flexibility due to fast-changing service requirements. Projects of less than A$50m (£20m) capital value are 'uneconomic' because of high transaction costs.

The government's fiscal framework

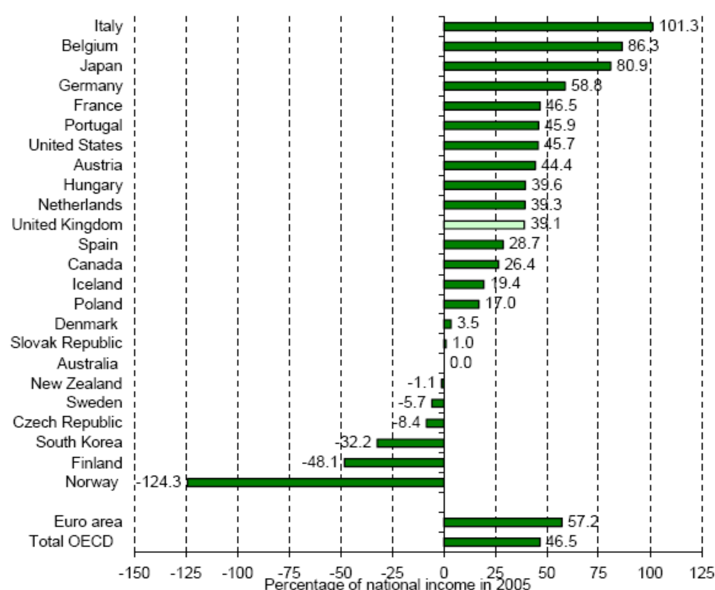
The 1997 Labour Party general election manifesto made a commitment to two financial rules which were later adopted in the 1998 Finance Act.

> **the 'golden rule':** the government will only borrow to fund investment and will not borrow to fund non-investment spending. In other words, tax revenues should equal or exceed the 'current budget'. The rationale for this rule is that future generations of taxpayers should only be asked to repay debt related to investment from which they also benefit such as the continued availability of schools and hospitals. It is also supposed to act as a disincentive to cut infrastructure spending if there is a public spending crisis in the future.
>
> **the 'sustainable investment rule'**: the public sector's net debt (excluding financial assets which are mainly foreign exchange reserves) should be kept at a 'stable and prudent' level and should not exceed 40% of national income at the end of each fiscal year.

Government debt ratios

The general government debt ratio in Britain was 39.1% in 2005 but this figure has varied considerably from 26.2% in 1990-91 rising to 43.6% in 1996-97, declining again to 30% in 2001-02 as a result of the surpluses operated in the early part of Labour's administration and helped by the A$56 billion (£22.5 billion) proceeds from the 3G mobile telephone licences (IFS, 2006). There is no fixed percentage and figure 3 illustrates there are wide differences between OECD countries. The IFS believe that the 40% figure was chosen as a commitment not to allow debt to rise above the level inherited from the Conservatives (ibid).

Figure 1: **General government debt ratios in OECD countries in 2005**



Note: Data for the United States include outlays net of operating surpluses of public enterprises.
Source: Annex table 33, OECD Economic Outlook 78 database, December 2005, http://www.oecd.org/document/61/0,2340,en_2825_32066506_2483901_1_1_1_1,00.html.

PPP/PFI in neoliberal context

Neoliberalism is a conservative economic philosophy which revived in the late 1970s following the crisis in Keynesian economics, escalating inflation at the end of the post-war reconstruction boom, the soaring cost of the US war in Vietnam and the 1973 oil shock. Governments had difficulty financing budget deficits, which led to the imposition of restrictive monetary policies and cuts in public expenditure. The Thatcher and Reagan government's in the 1980s abandoned the policy of state intervention to maintain full employment. They deregulated financial and labour markets, reduced corporate and top personal tax rates, privatised public assets, promoted free trade and small government.

International capital is the main driving force behind neoliberalism seeking new markets, increased profitability and restructuring economies to create the political and economic conditions to increase capital accumulation. The role of PPP/PFI projects in supporting and promoting the eight elements of neoliberalism is summarised in Table 9 and examined below.

Table 9: **Components of Neoliberalism**

Components of Neoliberalism	
Liberalisation and competition	Privatisation
Marketisation	Consumerism
Deregulation of financial markets	Labour market flexibility and deregulation
Reconfiguring the role of the state	Increasing power of business in public policy making

Source: Whitfield, 2006.

Liberalisation and competition: Compulsory Competitive Tendering (CCT) and market testing were 'abolished' by the Labour Government but there was never any question that this would apply to PPP/PFI projects and public bodies have been very reluctant to even make the case for the exclusion of support services. PPP/PFI and Strategic Service Delivery Partnerships (SSPs), together with the Best Value regime, have mainstreamed competition and contestability in a wider range of services. A broad range of Facilities Management (FM) and corporate services are now subjected to competition. As noted above, the new NHS LIFT and BSF models provide access and opportunity for the private sector to widen the scope of PPP/PFI projects to embrace core services.

There will be further transfers of design, planning and technical skills to the private sector as architectural design and construction related technical services are a key part of the DBFO approach.

Markets: PPP/PFI projects have extended and deepened existing markets in support services and created opportunities for the outsourcing of core services as discussed in chapter 2. PPP/PFI has resulted in an increase in the volume of services subjected to competition and available to large FM companies. It has also widened the scope of the market by expanding the range of services falling within the scope of FM and ICT. Public bodies have often widened the range of services, particularly in SSPs, in order to attract sufficient high quality bidders. The procurement process is in effect a driver to open up more services to competition and to come within the scope of PPP/PFI and SSP projects.

Deregulation of financial markets: PPP/PFI projects have increased the free flow of capital globally and created new opportunities for accumulation. British, Australian and foreign financial institutions have financed PPP/PFI projects at home and abroad. They have also hastened deregulation of financial markets in developing countries as most major projects are financed internationally through lead financial institutions.

Reconfiguring the role of the state: The commodification of risk, how it is identified, apportioned and priced, plays a central role in PPP/PFI projects. Some risks are transferred to the private sector but at a price. But political risk remains with the public sector. The construction of most public sector infrastructure projects have always been undertaken by the private sector and most contractors have well resourced teams to maximise additional payments for design and specifications changes, apportionment of responsibility for delays and so on. Public sector contracts often suffered delays and cost overruns. PPP/PFI projects guarantee much higher profits to contractors who also have long-term facilities management contracts and thus are more likely to deliver on time and to budget.

The conversion of infrastructure provision into the delivery of a service has important consequences for the role of the state. If the state 'does not need to own the infrastructure' and if the infrastructure can be commodified as a service then surely there can be no boundary between the services related to the building, the corporate and support services required to facilitate the operation of the building and delivery of the core service, and the delivery of the core service itself.

Privatisation: PPP/PFI has increased outsourcing of corporate and technical services as public sector organisations have relied on consultants and advisers and support services have been included in facilities management contracts. The widening scope of PPP/PFI projects and partnership models is already leading to the inclusion of some core services.

Consumerism: The separation of infrastructure from services and reconfiguring of the user/state/private sector relationship encourages the belief that 'it does not matter who owns the buildings or provides the service'. Similarly, SSP projects increasingly focus on the provision of customer service centres. However, 'customer care' can divert resources from improving the quality of core services.

Labour market flexibility and deregulation: A degree of re-regulation has resulted in increased protection of staff in PPP/PFI projects but this has also served to make the transfer of staff between public and private sectors more politically acceptable. PPP/PFI projects have had a key role in legitimating the outsourcing of support services. SSPs have a key role the efficiency and the business process re-engineering and transformation agenda in which promotes increased labour flexibility and the application of private sector values and priorities.

Increasing the power of business coupled with the erosion of democratic accountability and transparency: PPP/PFI has consolidated the market power of construction companies which also have facilities management subsidiaries. Financial institutions have had a pivotal role in influencing the government's PPP/PFI policy and regulatory frameworks. PPP/PFI special purpose vehicles, new private sector dominated companies within the public sector and partnership boards help to legitimate the formation of arms length companies and trusts which further erode democratic accountability.

Economics of PPP/PFI

The total PPP/PFI capital expenditure in Britain of A$187.5 billion (£75 billion) by 2011 is only part of the picture because the availability and facilities management costs are excluded. Total capital

and revenue expenditure is estimated to be A$837 billion (£335 billion) by 2011 because capital expenditure accounts for, on average, only 22% of total PFI project costs (Andersen, 2000).

In the Pre-Budget Report (2005) and the 2006 Budget report the Treasury provides details of the estimated annual public sector payments under PFI contracts. They show a rise from A$16 billion (£6.4 billion) in 2005/06 to A$18.75 billion (£7.5 billion) by 2015/16 and then a gradual decline until 2030/31 and beyond. The intended impression is that payments are going down. But this is a gross distortion of reality. Alongside the Budget the Treasury published a new PFI report which committed the government to a further 200 PFI projects by 2010 involving A$65 billion (£26 billion) capital expenditure (HM Treasury, 2006a). The Treasury's presentation of declining PPP/PFI payments relates only to the situation in March 2006 and the direction of the graph is less relevant than the size of the annual commitments which are rising as more and more PPP/PFI projects are signed. The Treasury presentation is distorted on two counts:

Firstly, it does not take account of the PFI projects currently in the planning and procurement process, the vast of majority of which are almost certain to proceed.

Secondly, it is almost certain that PFI projects will extend beyond 2010. If PFI approvals continue at the same rate between 2010 and 2025 then a further A$244 billion (£97.5 billion) of PFI capital expenditure could be signed bringing the total to over A$345 billion (£170 billion) (This would amount to A$1,950 billion (£780 billion) in public sector revenue commitments by 2025).

Advantages for capital

The economic advantages of PPP/PFI centre around three claims . Firstly, the transfer of risk from the public to the private sector, in particular the design and construction risks that the project will be will on time and within budget. Although PPP/PFI projects take on certain risks, financial institutions operate to minimise risk transfer. The public sector retains political risks if the project goes wrong. Secondly, whole life costing includes regular maintenance, replacement and renewal over the period of the contract and ensure the full cost of an infrastructure asset is recognised and costed at the procurement stage. Thirdly, an integrated approach to facilities management will produce economies of scale and improve efficiency.

The PPP/PFI process has created new opportunities for the private sector to obtain additional work and extract profit. It is guaranteed the design, build, finance and operate elements but in addition it is able to extend this to new stages in the infrastructure process. Table 10 compares the stages in a public sector infrastructure project and a PPP/PFI project. The first has six stages which also includes the procurement and construction process in contrast to ten stages in the PPP/PFI process. The primary difference is the additional four stages in the PPP/PFI model which enables private capital to extract fees and profits.

There are other key differences between the two processes:

- Financial, legal and technical consultants are used more extensively in the PPP/PFI model, for example in stages 1, 4, 5, and 7.
- Financial fees can be extracted at stages 4, 8, 9 and 10.

Table 10: **The additional stages for profit in PPP/PFI projects**

Stages in a public sector infrastructure project	Stages in a PPP/PFI project
1. Planning and capital programme	1. Project planning and preparation of Business Case – consultants/advisers
2. Land acquisition	2. Land acquisition
3. Design	3. Design
4. Financial and legal advice	4. Project finance – arrangement fees
5. Procurement and construction	5. Procurement process – consultants/advisers

6. Management and operation	6. Construction
	7. Management and operation – retendering and possible further use of consultants
	8. Refinancing of PPP/PFI project – financial fees
	9. Sale of equity in PPP/PFI projects – financial fees
	10. Operation of Infrastructure Funds – financial fees

The design and structure of PPP/PFI projects enables them to be bought and sold thus creating a new market. PPP/PFI is attractive to capital for other reasons:

Infrastructure provides:

- A relatively low risk investment with high returns usually between 12% - 15%.
- Many projects have a monopoly position with no or few competitors.
- High barriers to entry through high development and construction costs and long term contracts.
- The essential and long-term nature of infrastructure assets has traditionally led to stable and predictable consumer demand, resulting in cash flows that can be more reliably predicted than those generated by other types of asset investment. The marketisation of public services poses a challenge to this situation.
- The impact of economic downturn is likely to be moderated because infrastructure provides essential and basic services for which demand will continue, for example, transport, health, education and criminal justice activities.
- Higher growth potential – once property is occupied it has limited growth in contrast to toll roads which can increase traffic volumes without needing to invest significant additional capital.
- Many infrastructure projects operate within regulatory frameworks which permit inflation-based increases to be passed onto users.
- Contracts can be renegotiated, despite the original claim that PPP/PFI contracts were ‘set in stone’.
- Ownership of the infrastructure facilitates access to the provision of core services within the scope of PPP/PFI projects.

Part 3

The long-term impact of PPP/PFI

The PPP/PFI debate to date has been limited to a discussion about the relatively short-term effects of projects, in particular the financial, legal and political framework within which projects are designed and procured. This debate has focused on:

- The power of government to enter into legally binding long-term contracts for infrastructure projects.
- The standardisation of contracts to provide a common template to reduce the time and cost of PPP/PFI projects.
- The transfer of risk – its identification, allocation and pricing.
- Value for money and the public sector comparator methodology.
- The inclusion or exclusion of support services in the scope of projects.
- The degree of competition in the procurement process and the high level of transaction costs.
- Establishing a PPP/PFI organisational structure in government departments and other public bodies to promote and mainstream PPP/PFI policy.

This inward looking perspective is a consequence of the economic rationale for PPP/PFI and the claim that "it is the only show in town" and there is no alternative method of financing badly needed investment in the public infrastructure. This will be discussed more fully in part 3.

The longer-term consequences of an increasing part of the local and national infrastructure being managed and controlled by the private sector is rarely considered. Not surprisingly, the PPP/PFI lobby of contractors, financial institutions and consultants want to rapidly expand and embed PPP/PFI globally.

This chapter examines the longer term implications for government, the public sector, the infrastructure, services and users/community organisations and staff/trade unions of the continued expansion of PPP/PFI. It also discusses the potential effect of new PPP/PFI models in Britain such as NHS Local Improvement Finance Trusts, Building Schools for the Future and a similar model planned for housing and regeneration.

In order to assess the extent to which the longer term impact of PPP/PFI has been considered in policy and research reports, a sample of 25 studies was examined from Global/European (3 studies), British (18) and Australian (4) sources. They are divided into three groups - government policy and evaluation reports, consultants and business reports and academic/policy studies. The criteria for selection included studies which had an objective of providing an overview of PPP/PFI policy and performance and those which had been published since 2000.

Policy analysis and evaluation of PPP/PFI is constrained by a number of key factors. Firstly, the combination of political and economic vested interests of public sector organisations, major construction companies and financial institutions that PPP/PFI is 'working well'. They also maintain a collective illusion, aided and abetted by the four large accountancy/management consultancy firms, that options appraisal and business case development is 'scientific' and based on analysis of alternatives when in fact it is frequently contrived because PPP/PFI is 'the only show in town'.

Secondly, the scope of evaluation is determined by a narrow definition of value for money which excludes a full consideration of equality and equity issues, social justice, employment, sustainability and community well-being.

Thirdly, rigorous, indeed any kind of local scrutiny, is virtually non-existent. There have been very few PFIPPP projects which have been scrutinised by local authorities or other public sector bodies either in the planning, procurement or operational stages. The lack of scrutiny also means that PPP/PFI secrecy is rarely challenged by public bodies, except by users and trade unions during the procurement process. Only five local authority scrutiny studies - Cornwall, Derby, Leeds,

Camden and Sandwell – have effectively scrutinised PPP/PFI and most of these were during the operational phase. Gateway Reviews are a form of scrutiny but they are essentially about getting the PPP/PFI procurement process ‘right’.

Fourthly, only a limited number of studies and surveys have sought to provide the opportunity for service users and staff, rather than PFI managers and advisers, to express their views. Most PPP/PFI advocates refer to the fact that projects have some form of user/staff participation during the procurement process. However, this is usually either focused on design issues for users and employment matters for staff and is concentrated on selecting the best bid, not whether the project is the best option. This has often already been decided behind closed doors.

Long-term perspective

The definition of a long-term perspective in this report includes:

- Examination of the future implications of current policies, combinations of policies and their cumulative effects.
- Adoption of a political perspective looking beyond the mechanisms of PPP/PFI finance, project design, the procurement process and operational performance.
- Exploration of the consequences of new models as PPP/PFI are embedded in the public sector and the economy.
- Identification of the potential issues which may arise on completion of the contract, for example, the ownership of assets, the capacity of the state to manage and operate infrastructure.
- The potential impact of the growth of PPP/PFI equity sales, a secondary market and the widening role of private finance of infrastructure and public services.

The continued expansion of PPP/PFI raises many questions about the longer term impact of this policy. For example:

1. What will be the effect of the vast majority of major hospitals being PFI hospitals (PFI accounts for between 85%-90% of major NHS capital expenditure). In 2005 there were 123 PPP/PFI schemes which were either completed or in development that counted towards the NHS Plan compared to just 11 publicly funded projects.
2. What will be the effect of the extensive marketisation of public services on PPP/PFI projects?
3. What is the longer-term effect of off-balance sheet financing of infrastructure projects?
4. What will be the consequences when 50% of people in England are using LIFT primary health care facilities by 2008?
5. What will be the knock-on effect when most secondary schools in England are part of BSF projects with privately controlled Local Education Partnerships operating in local authorities with educational responsibilities?

Assessing whether long-term impact has been taken into account

Most of the 25 studies in the sample (see table 11) had objectives which did not explicitly mention taking a long-term perspective or assessing the wider implications of current policies. However, it is the responsibility of researchers and policy advisers to identify the wider implications of policies and projects. Those who set the terms of reference and parameters of research must bear equal responsibility for the lack of a longer-term perspective.

Table 11: **Analysis of PPP/PFI documentation for long-term impact analysis**

Analysis of long term impact in PPP/PFI documentation	
Title of study	**Comments on scope of content**
Global/European	
Public Private Partnerships (International Monetary Fund, 2004)	Focus on economic policies, fiscal accounting and reporting and experience in various countries. No analysis of longer-term

	impacts.
Evaluation of PPP Projects Financed by European Investment Bank (EIB, 2005)	Evaluation of 15 projects, 10 in detail, which did assess some wider political and economic issues.
Delivering the PPP Promise: A Review of PPP Issues and Activity (PricewaterhouseCoopers, 2005)	Limited to a review of PPP activity, procurement models and recurring issues and solutions.
Britain	
Government policy and evaluation of PPP/PFI	
Meeting the investment Challenge (HM Treasury, 2003)	Sets out government approach and justification for PPP/PFI, reform measures, current performance but no analysis of longer-term consequences for public sector.
Strengthening Long Term Relationships (HM Treasury, 2006)	Focus on improving procurement process and performance, flexibility of private finance and transparency to make 'better projects' but no analysis of longer-term consequences for public sector.
Update on PFI Debt Financing and the PFI Equity Market (NAO, 2006)	Examines growth of PFI equity market and refinancing, very limited discussion of effect on future liabilities and performance and no assessment of long-term impact.
Framework for Evaluating the Implementation of PFI Projects (NAO, 2006)	Matrix to assess implementation and VFM at four key stages but even 'mature' operation fails to assess wider/longer term issues.
Operational PFI Projects (Partnerships UK, 2006)	Limited to operational review and survey findings with barely a concern about medium, let alone long-term perspective.
Public Private Partnership Programme evaluation of Westminster, Milton Keynes and Sheffield SSP projects (4ps, 2006)	Rationale for SSP and analysis of procurement and implementation but no assessment of wider or long term issues.
Innovation in the NHS: Local Improvement Finance Trusts, (NAO, 2005)	Narrow assessment of LIFT projects and no wider or long tern analysis.
PPP/PFI Consultants and Business reports	
European PPP Report 2005 (DLA Piper Rudnick Gary Cary, 2005)	A market survey of current trends and developments. No long-term analysis.
Partnering in Practice: New Approaches to PPP Delivery (PricewaterhouseCoopers, 2004)	Explores new forms of partnering in pro-PPP context but avoids long term debating consequences.
Delivering for Local Government: The Impact of Public Private Partnerships (Confederation of British Industry (2003).	Selective 'historical' analysis of competition and contestability with no examination of longer-term implications.
Academic and policy studies	
Evaluating the operation of PFI in Roads and Hospitals (Edwards, Shaoul et al, 2004)	Examines financial performance and accountability, management of contracts, value for money, risk transfer. Comprehensive here and now analysis.

In the Interests of Profit at the Expense of Patients (Aldred for UNISON, 2006)	Examines NHS LIFT model and some discussion of future impact on clinical services.
Public Risk for Private Gain? (Pollock and Price for UNISON, 2004)	Assessment of risk assessment in NAO project evaluations but critique does not address longer-term issues.
3 Steps Forward, 2 Steps Back: Reforming PFI Policy (IPPR, 2004)	Examines recent PPP/PFI progress and proposes improvements to VFM, workforce issues and accountability but no long-term analysis.
Public-Private Partnerships: Lessons from the British Approach (Spackman, 2002)	Focus on evolution, implementation and lessons learnt and critique of current policy. No long-term impact assessment.
PPPs and the Changing Public Sector Ethos: Case Study Evidence from the Health and Local Authority Sectors (Hebson et al, 2002)	Analysis of effect on public service ethos with some wider analysis but no long-term assessment.
Building Better Partnerships: Commission on Public Private Partnerships IPPR, 2001)	Promoted PPP/PFIs in mixed economy service provision, diversity partnership models but did not address longer-term implications.
Economics of the Private Finance Initiative in the NHS, (Sussex, Office of Health Economics, 2001)	Analysis of costs and benefits, VFM with some analysis of implications for future policy eg inclusion of clinical services.
Australia	
Government policy and evaluation of PPP/PFI	
New South Wales Public Accounts Committee Inquiry into PPPs (June 2006)	Overview of PPP process drawing on PPP lobby overseas. No analysis of wider public sector or long-term issues.
Review of Partnerships Victoria Provided Infrastructure (Fitzgerald, 2004)	Overview of current practice, questionable use of UK evidence, lack of wider and longer term analysis.
Review of Future Provision of Motorways in NSW (Richmond Review, 2005)	Limited discussion of wider urban impact, focus on PPP process and no long-term analysis.
Academic and policy studies	
UNIONS NSW submission to Parliamentary Inquiry into Public Private Partnerships (Centennial Consultancy, 2005)	Analysis of current policies and practice but lacks analysis of long term implications.

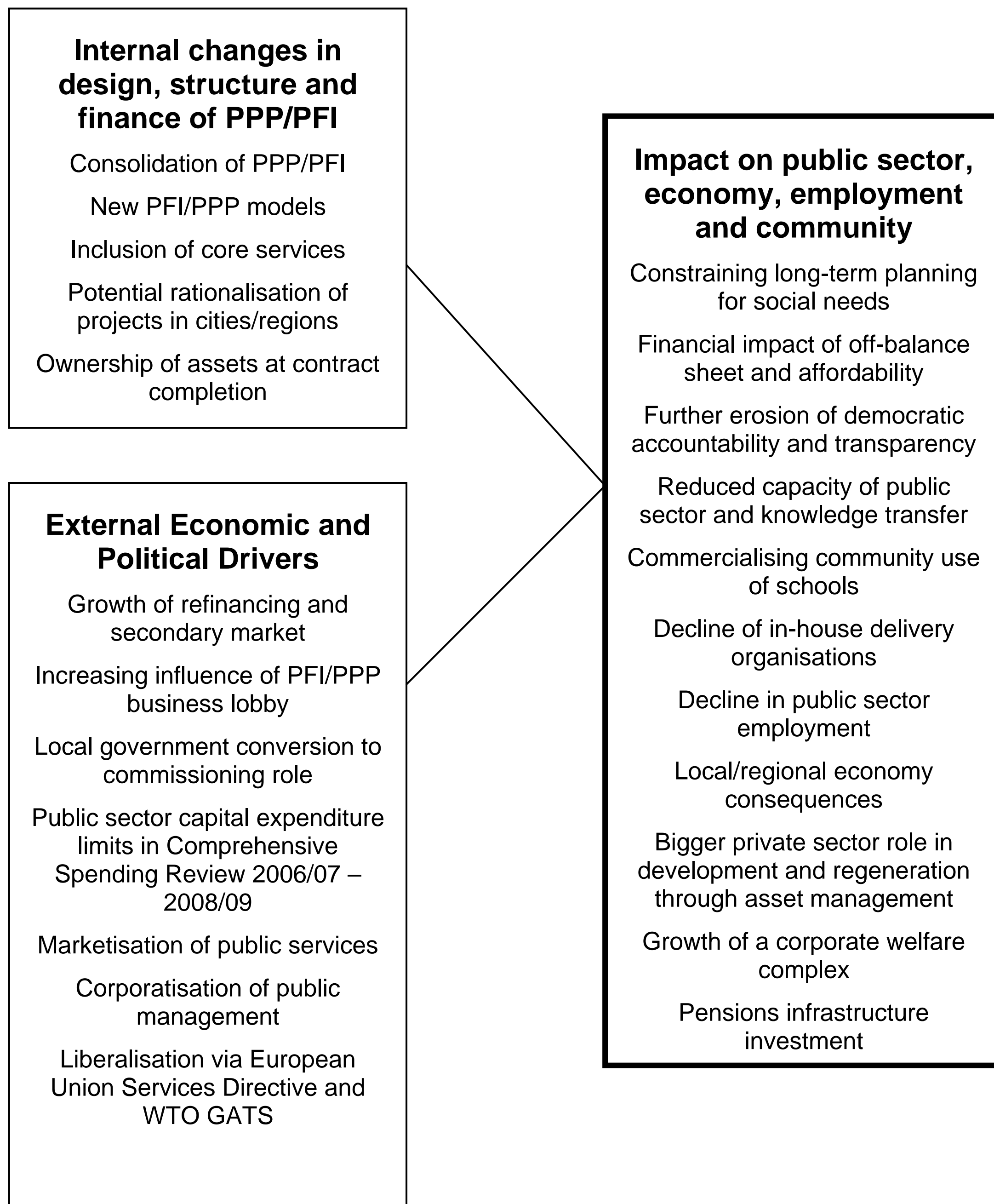
Studies which did examine the wider and long term implications but are not included above are include Whitfield, 2001, Spoehr et al, 2002 and Centre for Public Services, 2002. PPP/PFI developments since 2001/02 mean that a broader and deeper analysis is more critical than ever.

Assessing the long term implications of PPP/PFI

Three major factors influence the long-term impact of PPP/PFI projects. Firstly, internal changes in the design, structure and finance of PPP/PFI models and policies, in particular the financial and regulatory frameworks. Secondly, external economic and political drivers such as the growth of a secondary market, government modernisation policies and European/WTO legislation. Thirdly, external impacts on the public sector, economy, employment and community such as the effect on

democratic accountability, decline of in-house delivery and reduced public sector capacity (see Figure 1). The rest of this chapter discusses each of these elements in more detail.

Figure 1: **A framework to assess the long-term impact of PPP/PFI**



Internal change in PPP/PFI

Consolidation of PPP/PFI

The government is committed to a further five year PFI programme consisting of another 200 projects with a capital value of A$65 billion (£26 billion) (HM Treasury, 2006a). PPP/PFI ideology and practice is embedded in all government departments and in public sector planning and management generally with little sign of it being reduced, let alone terminated. Of course, increased political opposition could change this situation. Equally, a change of government in Britain is likely to see the PPP/PFI programme accelerated.

New PPP/PFI models

A new housing/regeneration model of the Private Finance Initiative (PFI) is under review by the government which is assessing whether it should be a partnership or project delivery model – a Building Schools for the Future model rather than the NHS LIFT type model (HM Treasury 2006). Nine social housing PFI projects have been signed to date with a total capital value of A$1,750 million (£429 million), increasing the number of decent homes by 8,000. A further 15 projects are in procurement.

A new PPP/PFI waste/environment model may also emerge. Additional models are almost certain to be developed which may have a broader scope and reflect the need for more integrated serviced delivery or a one stop shop approach. Ironically, as competition and contestability are mainstreamed in the public sector, criticism of the multiplicity of contracts, fragmentation of delivery and high transaction costs is likely to lead to larger multi-service contracts with transnational companies and partnerships!

Of course, there are different types of partnerships but PPP/PFI is a particular contractual arrangement and is only a partnership in the sense that the public sector agrees to pay the private sector to design, build, finance and operate facilities for use by the public sector. It is based on a 25-35 year contract which binds the public sector into a stream of payments, whilst the private sector can sell-off its stake and/or refinance the project at any time (or may be acquired by another company). It bears little resemblance to a political partnership of equals with shared interests and mission. Once PPP/PFI consortia construct a building and it is operational, much of the risk is eliminated except for maintaining the building, delivering support services and planned refurbishment.

More partnerships are developing between construction companies and financial institutions. Bovis Lend Lease and Bank of Scotland established a partnership, Catalyst Investment Holdings, in May 2006 to target social PFI projects. The partnership will enable the companies to pool assets and retain primary investments. The Swedish construction company Skanska has a similar partnership with financial investor Innisfree as do Balfour Beatty with the Royal Bank of Scotland and HSBC. The longevity of these partnerships will almost certainly depend on market conditions and the relative financial advantages of retaining or selling assets.

Very large infrastructure transportation projects usually have a consortia consisting of a partnership of two or more major construction companies. As projects grow in size and scope, for example the A$2.5 billion (£1 billion) St Bartholomew and London Teaching Hospitals project and Birmingham City Council's A$5.5 billion (£2.2 billion) highways upgrading and maintenance project, so partnerships between major contractors are also likely to increase.

The new PPP/PFI models, LIFT and BSF, extend the role of the private sector very significantly. Firstly, LIFT projects give the private sector exclusive rights to develop primary care facilities in its area. At the end of the 20-year contract buildings remain in private ownership unless they are purchased by the NHS. Secondly, most BSF projects require a Local Education Partnership (80% controlled by the private sector) which also has exclusive rights to additional new build or refurbishment work. BSF also engages the private sector in ICT and educational support services provision. The extent to which the private sector can gain a foothold in these services will vary between local authorities. But evidence from BSF bids clearly indicates that education consultants have the broader 'children's services' agenda in their sights, not just school based services.

Both models are significantly different from the traditional PPP/PFI model because they provide additional development opportunities (land and buildings) and substantial scope to increase the range of public services they provide over the length of the contract.

Core services could increasingly come within the remit of PPP/PFI projects

There are no significant technical, legal or financial reasons for limiting the operational element of PPP/PFI projects to facilities management of buildings and the provision of soft services. The private sector already builds new prisons and provides a 'full service provision' of accommodation, security and training. The main obstacles to the private provision of core services are political and the capacity of the private sector. The 'education market' also includes nursery schools, children's centres and after school services. The private sector sees no barriers between primary and secondary education and childcare provision, just one big market.

> *"Education demonstrates very clearly how a core service can become highly vulnerable to outsourcing and privatisation. The teaching profession has been encircled by different forms of marketisation and privatisation to such an extent that it now makes the position of teachers highly vulnerable. The private provision of supply teachers, academies, the increasing outsourcing of educational support services, privately financed school buildings, and privately controlled Local Education Parnerships in the Building Schools for the Future programme preceded government plans for schools to become trusts employing their own staff, owning schools and playing fields and managing admissions.*
>
> *The ramifications of these policies have yet to be fully understood. Local bargaining could have a major impact on teachers' pay and conditions. But more is at stake – the privatisation of a public good. Secondary and primary education may remain largely state funded for the foreseeable future, but they will be delivered mainly by private contractors"* (Whitfield, 2006).

In Britain the government has concluded that PPP/PFI has not produced a step change in the quality of facilities management services. However, the eight tender documents for the 4th wave of the NHS LIFT programme now include soft FM services previously excluded from LIFT projects and they explicitly refer to clinical services. Some tenders refer to "the provision of sports and leisure facilities, libraries, museums and other community centre facilities" (UNISON, 2006). The new emphasis on super-surgeries and community provision of health services is almost certain to reinforce this approach.

One of the first Independent Sector Diagnostic Treatment Centres in the NHS was an ophthalmic contract with Netcare Healthcare Ltd. It involved the private sector providing and operating specialised mobile treatment units to carry out cataract operations around Britain. PPP payments were contingent on the provision of completed healthcare services rather than the availability of premises.

In Australia, PPP documentation defines core and non-core services. Core services are those that "involve direct delivery of community services to the public or the exercise of statutory power, or those over which the government wants to retain direct control" (Sharp and Tinsley, 2005). Victoria, Western Australia and New South Wales give examples such as police services, public education, medical services in public hospitals and the judiciary (ibid). Some States and the Department of Defense "expressly preclude involvement in the provision of core services" (ibid).

Potential rationalisation of PPP/PFI projects within cities

Each PPP/PFI project has its own Special Purpose Vehicle (SPV) and facilities management contract. However, as the number of PPP/PFI projects increases in each city so does the scope for further efficiency and economy of scale gains by merging the delivery of facilities management. In addition, the growth of the secondary market will lead to investment trusts building up a portfolio of PPP/PFI projects which could also lead to rationalisation in the search for further efficiencies and higher returns.

Completion of the contract

The easiest longer-term issue to confront is what happens when the contract reaches its conclusion after 25 years (or 10/12 years for SSP projects). It is standard practice, except for NHS LIFT projects, for assets to be transferred to the public sector at the end of the contract. But we are told the public sector is not acquiring an asset but purchasing a service!

It is frequently stated that there is little interest in what happens at the end of long-term 25-35 year contracts because 'a week in politics is a long time'. But politics has always been about the long term as well as immediate and short term issues – the welfare state, pensions, the quality of education, which all require long term planning and commitment. The current focus on the sustainability of plans and buildings also requires a long-term perspective.

As more and more PPP/PFI projects are signed, what happens at the end of the contract, particularly the willingness and ability of the public sector to takeover responsibility for assets, becomes more relevant. There are three possible scenarios at the conclusion of PPP/PFI contracts.

In the first scenario, the assets are transferred to the public sector which takes over responsibility for services either through in-house provision or outsourcing. Contractual disputes may arise over the condition of buildings at the end of the contract despite contractual requirements to maintain them in good condition and undertake post-handover surveys. The asset would also appear in the national accounts valued as an asset (or liability) since it may previously have been considered off balance sheet.

In the second scenarios, a transfer does not take place because a new PPP/PFI is procured to improve and reconfigure accommodation to meet the new needs and circumstances prevailing at the time. In addition, the public body no longer has any direct labour facilities management staff and a new PPP/PFI contract enables it to continue with long-term outsourcing. This scenario would make the Treasury forecast of declining PPP/PFI contractual payments after 2015 fundamentally wrong.

The third scenario assumes that by 2020 there have been substantial changes in both the public and private sectors. Local government may have changed radically following New Labour's modernisation by marketisation strategy, the Lyons review and the consensus that local government should commission and outsource services instead of direct provision. PPP/PFI projects increasingly include core service provision. School trusts and foundation hospitals outsource core and non-core services to asset management and managed service companies. So as PPP/PFI projects come to an end, a new PPP/PFI project is likely to be procured which further widens the range of core services outsourced to the private sector.

External drivers

Growth of investment trusts with holdings in PPP/PFI projects

Infrastructure investment has entered a new phase with the formation of new European and global infrastructure investment trusts, the increased flow of pension funds into infrastructure and the acquisition of privatised infrastructure assets by investment trusts.

Many privatised assets sold via share flotation in the 1980s and 19990s, particularly in the utility and water sector, were subsequently acquired by European and US energy companies. Some of these assets are now being acquired by infrastructure investment trusts/banks, with assets transferring from utility sector to ownership by financial institutions. The financial institutions are also turning their attention to the social infrastructure, such as schools and hospitals, in addition to transport and utilities. For example, Macquarie recently acquired Thames Water from the German RWE group for A$21bn (£8bn) and Osprey Acquisitions (Canada) has made a A$5.7bn (£2.2bn) bid for Anglian Water. Infrastructure funds are expected to compete successfully against private equity buy-out groups because they have accepted long-term cash/dividend yields in contrast to the short-term restructure and sale tactics employed by private equity groups.

Australia's Macquarie Bank has invested heavily in infrastructure in Europe with pension funds playing a significant role (Global Pensions, March 2006). "In defining infrastructure, we really look at three core characteristics: if something provides an essential service to the community, if it has some kind of protection from competition, and if it generates stable and sustainable cash flow over an extended time horizon" stated Jim Craig, head of Macquarie Group in Europe (Financial Times, 2006). This seems to be a clear case of aversion to risk transfer and competition and a search for cash generating monopoly essential services.

Another example is Barclays Bank. It has raised over A$2.6bn (£1bn) for two European infrastructure funds, a student accommodation fund and the Infrastructure Investors fund to invest in operational PPP/PFI projects.

As investment trusts increase PPP/PFI assets acquired in the secondary market, they will be responsible for facilities management and will want to obtain economies of scale and rationalisation to maximise the return on investment. They are almost certain to continue to outsource FM services. The NAO report on refinancing and the secondary market noted that funds may be able "to improve their returns by efficient management of the operational activities of the projects within their portfolio" by concentrating on efficient asset management (NAO, 2006).

"Any gains which arise from an efficient asset management approach are operational profits outside of the code and would not have to be shared with the public sector" (ibid).

The growth of investment trusts feeds into the asset-based welfare model whereby pension funds, child trust funds and other similar schemes will be invested in trusts, which could be branded as new forms of 'community ownership'.

Increasing influence of PPP/PFI business lobby

The growth of PPP/PFI projects will inevitably result in the exponential increase in the power of business interests. The PPP/PFI industry consisting of the major construction companies, banks and other financial institutions, the big management and accountancy consultancies, lawyers and technical advisors and the business services trade associations are lobbying for widening the scope of PPP/PFI and developing new models. Already a number of PPP/PFI lobby organisations such as the PPP Forum in Britain (sponsored by 33 major contractors, 44 financial institutions and 35 consultancies/advisors), the Confederation of British Industry's Public Services Strategy Board (80% of the non-CBI executives represent major PPP interests) plus many Global, European and US business organisations promote PPP/PFI. Many corporations fund right wing 'think tanks' which extol the virtues of private investment in public services. The World Bank and other development agencies have used PPP/PFI as a condition of aid. There are also numerous PPP/PFI journals which advocate the expansion of PPP/PFI globally.

The Australian Council for Infrastructure Development (AusCID) and the National PPP Forum perform a similar role in Australia.

The role of these organisations is reinforced by visits from foreign delegations. The first overseas visit for the NSW Public Accounts Committee inquiry into PPPs overseas trips was the PPP Forum in London followed by the 4ps, HM Treasury, PricewaterhouseCoopers, Serco Institute, National Audit Office and Partnerships UK. This selective investigation into PPP/PFIs continued in Washington DC where they visited the National Council for PPPs, the World Bank and the International Monetary Fund (New South Wales Parliament, 2006).

Local government conversion to commissioning role

New Labour's vision for the future of local government is focused on commissioning, choice, contestability and competition thus limiting their role to brokering, partnering, promoting, reconciling, strategic marketing and regulating. Outsourcing and the transfer of services and functions to arms length companies and contractors will be commonplace in this neoliberal model of government. Reducing and weakening the role of the local state will mean less capacity to directly provide services. The economic, resource and political drivers which created the conditions which encouraged or coerced local authorities into PPP/PFI projects will be even more prevalent.

Public sector capital expenditure limits in the new Comprehensive Spending Review (CSR) 2006/07 – 2008/09

The Comprehensive Spending Review (CSR) 2007 will be significant because it is the second Comprehensive Review since 1997 although there have been bi-annual spending reviews to determine public spending programmes. It will set departmental spending plans and priorities for the 2008/09 to 2010/11 period. The government is also undertaking a "fundamental review of the balance and pattern of public expenditure, taking stock of what investments and reforms have delivered to date and identifying what further steps are needed to meet the challenges and opportunities of the decade ahead" (HM Treasury, 2006b and 2006c).

The CSR review will take account of the rapid increase in the old age dependency ratio, the intensification of cross-border economic competition from emerging markets such as China and India, an acceleration in the pace of innovation and technological change, continued global uncertainty and increasing pressures on natural resources and global climate change.

The review will identify "a more strategic approach to asset management and investment decisions, ensuring the UK is equipped with the infrastructure needed to support both public service delivery and the productivity and flexibility of the wider economy" (HM Treasury, 2006b). It will also include "an ambitious and far-reaching value for money programme" and "zero-based reviews of departments' baseline expenditure to assess its effectiveness in delivering the Government's long-term objectives" (ibid).

It is widely expected that public expenditure will be 'tight', which is likely to mean increased reliance on PPP/PFI.

Marketisation of public services

Marketisation is the process by which market forces are imposed in public services, which have traditionally been planned, delivered and financed by local and central government. The process has five key elements:

- Commodifying (commercialising) services – services are changed so that they can be specified and packaged in a contract, thus extending outsourcing and offshoring. The infrastructure is also being commodified as PPP/PFI projects are used for the renewal, replacement and provision of new schools, hospitals, transport links, utilities and other facilities. What were previously 'whole' coordinated systems or networks of schools, hospitals, roads are divided into separate projects so that they can be privately financed and operated.
- Commodifying (commercialising) labour – the reorganisation of work and jobs to maximise productivity and assist transfer to another employer.
- Restructuring the state for competition and market mechanisms – schools, hospitals and other facilities are compelled to compete against each other, funding is changed to follow pupils and patients, public bodies are reduced to commissioning functions creating opportunities for private finance and so-called partnerships.
- Restructuring democratic accountability and user involvement – service users are treated as consumers; services and functions are transferred to quangos; arms length companies and trusts and privately controlled companies are established within public bodies.
- Embedding business interests and promoting liberalisation internationally – business is more involved in the public policy making process and promotes national, European and global liberalisation of public services.

The private sector does not consider BSF to be solely a building programme to improve secondary schools. They see it as an opportunity to widen and deepen the education market (Whitfield, 2006b). Many of the 'managed services' companies already have established education subsidiaries in response to the outsourcing of school inspections and 'failing' Local Education Authorities. BSF consortia include educational consultants and companies which are fervent believers that education provision should be commercialised, marketised and ultimately privatised.

PPP/PFI has extended existing or created new markets in:

- Private finance for infrastructure projects, insurance and related services.
- Facilities management of support services.
- New opportunities for education and health companies in policy making and provision, particularly through new PPP/PFI models by enabling private companies to provide educational services via the Local Education Partnership in the Building Schools for the Future programme and clinical services through NHS LIFT projects at the same time as public sector education and healthcare organisations are being forced into a commissioning role.
- Consultancy and financial, legal and technical advice for public sector clients, PPP/PFI contractors, members of the consortia and other companies in the supply chain.
- Design and technical services provided by private architects and design firms.
- Secondary market in the sale of equity and refinancing of projects.
- SSPs provide opportunities to widen the range of services in the bidding process and to incorporate additional services once the contract has commenced.

The marketisation of public services will have a significant impact on non-PPP/PFI buildings. Demand risk is retained by the public sector in PPP/PFI, particularly BSF and LIFT projects. Where there is a mixture of PFI and non-PFI buildings, public bodies will be forced to target change (such as budget reductions and reduced level of services) in the non-PFI facilities because they will be contractually committed to the unitary charge for PPP/PFI facilities

irrespective of whether they are used or not. The contractors obligation is to make them available for use.

When all facilities are PPP/PFI buildings then the public sector will have to pay the cost irrespective of what happens to the level of demand. It will retain the flexibility of closing or reducing the use of facilities but at great cost. This will mean that the relative cost of operating buildings and facilities will rise, thus putting additional pressure on the provision of services and on jobs, terms and conditions. Other services are likely to bear the brunt of budget reductions.

In an education market where a PPP/PFI school has declining performance and a smaller school roll, the local authority is likely to want to close a non-PPP/PFI school (because of the high termination costs in PPP/PFI schools) because it would be the lesser of two evils. In these circumstances the state would be subsidising the market. But the decision may also depend on the potential value of the PPP/PFI school land for alternative uses. If it can be sold for commercial or housing use and its value is greater than the cost of terminating the contract, then a PPP/PFI school might be closed rather than the non-PPP/PFI school. Much will depend on the location, the length of the remaining PPP/PFI contract and alternative potential uses.

Corporatisation of public management

The increasing use of outsourcing contracts, framework agreements and output based performance management systems means that accountability is increasingly determined by contract law. The widening role of PPP/PFIs and outsourcing in the public sector creates more opportunities for the private sector to define the scope and terms of the public policy making agenda. More partnership boards and Local Education Partnership/LIFT type private companies operating within the public sector is almost certain to result in a weakening of public service values and principles and their replacement by commercial values and criteria. Value for money could become the dominant, if not sole, operating criteria.

Just as the PPP/PFI 'industry' focuses on the internal processes and performance of projects so 'public' management will increasingly concentrate on outsourcing, procurement and contractual processes at the expense of the wider public interest agenda. The management of public bodies will be 'shared' by directly employed public managers but also by private sector managers in PPP/PFI and SSP projects and outsourcing contractors.

The emergence of private sector companies operating within public organisations raises some important issues about the effects of commercialisation.

> *Public sector share ownership in private companies operating within the local state:* Minority share holdings could lead to public interest matters being compromised. For example, the financial benefits of shareholding may conflict with other economic, social and political priorities. The evaluation and negotiation of proposals may be biased by the possibility of long-term financial accumulation from shareholdings taking priority over achieving short-term corporate objectives.
>
> *Senior public sector managers also directors of private sector companies:* Some senior managers will be a director of private companies where their legal responsibility is first and foremost to the interests of the company. This takes priority over the interest of their employer who they are representing which raises important questions about accountability and matters of public interest.
>
> *Strategic Partnership Boards:* Both the BSF and LIFT models have a Strategic Partnership Board consisting of local stakeholders to provide strategic direction to the project. But SPBs are usually not established until the project is approved and being developed and there are questions of accountability and representation – who selects, who approves, who is represented and how they are held accountable. Confusingly, SSP projects also have Strategic Partnership Boards but they are management, not stakeholder, boards.

These new structures and roles can only compromise the public interest, blur accountability and are more open to collusion or even corruption.

Liberalisation via European Union Services Directive and WTO GATS

The new European Union Services Directive is likely to consolidate the use of PPP/PFI for infrastructure projects and outsourcing of a wider range of services. Negotiations on the World

Trade Organisation's General Agreement for Trade in Services (GATS) have been, at least temporarily, delayed but could have a similar impact.

However, privatisation and marketisation is accelerating across Europe irrespective of these planned regulatory frameworks. Separate EU Directives on transport, postal services and utilities are driving liberalisation and competition. Similarly, PPP/PFI projects are growing in number and scope in all European countries.

The section above discussed the role of PPP/PFI in the marketisation of public services but this has had an impact beyond market mechanisms. Five distinct and overlapping methods are identified below:

European PPP/PFI market hegemony: The European Union and individual states, the European Investment Bank, the European business lobby and the PPP/PFI 'industry' have contributed to creating a 'European market' with similar legislative frameworks, financial mechanisms, project design and operating practices although there are wide differences in the number and type of projects across Europe. The 'common' PPP/PFI market is still developing and has grown rapidly before the EU Services Directive became effective.

Growth of transnational companies and consultancies: Construction companies, financial institutions, facilities management contractors and management consultancies have expanded and diversified in parallel with the growth of PPP/PFI markets and expansion to Eastern Europe. Hochtief (Germany), Ferrovial (Spain), Vinci (France), Skanska (Sweden) are examples of European construction companies with PPP/PFI teams operating in Britain and other parts of Europe. Financial institutions have also established project finance operations in many countries. Britain's Balfour Beatty has submitted PPP bids in Texas and California (PPP Bulletin, July 2006).

Promoting PPP/PFI ideology and values: This has ranged from promoting the principle of privately financed public infrastructure and neoliberal concepts about the role of the state to secondary market trading of PPP/PFI assets as 'normal' to the values which help to configure risk assessment, public sector comparators and evaluation criteria (HM Treasury, 2006a).

Embedding the procurement process in public management: The PPP/PFI procurement process, in particular the preparation of a Outline/Strategic Business Case, risk assessment, the negotiated tendering process and the selection of specific narrowly defined evaluation criteria are embedded in public policy frameworks, organisational structures and management practice (ODPM and LGA, 2003).

The transferability of labour: Facilitating the transfer of staff between employers and sectors whilst simultaneously encouraging the mobility of labour.

These developments are happening in advance of EU and WTO liberalisation regulations.

External Impacts

Constraining long-term planning for social needs

The fragmentation of the infrastructure into separate PPP/PFI projects with different private consortia, responsibilities and contracts, leaving the public sector responsible for the remaining, mainly ageing infrastructure, makes long-term planning for social needs more complex and difficult.

Social needs such as the provision of educational facilities will be influenced by international financial interests and private contractor's corporate strategies in a much more significant way than in the past. Community planning will be weakened by market forces and the role of regulators. A community perspective will be more difficult to sustain because of competing commercial interests.

It has suddenly dawned on the PPP/PFI sector that the marketisation of public services threatens the development of a private sector monopoly of infrastructure provision. Creating a market with pupils free to move to the 'best' schools could leave some PPP/PFI schools with falling rolls and facing potential closure. This would have a significant financial impact on both the local authority and the PPP/PFI consortia. It is driving a view that demand risk should remain with the public sector. It also supports the case to extend the scope of PPP/PFI projects into teaching to try to ensure a school remains 'competitive'.

Economic impact of off-balance sheet and affordability issues

Infrastructure gap: The PPP/PFI lobby claims that there is a growing gap between investment needs and the available public resources. It is commonly stated that "the alternative to PPP/PFI is no project or at least no project within the foreseeable future, rather than a public-procurement project" (EIB, 2005). The idea that 'more can be delivered earlier' would be appealing if there were not wider and long-term consequences. More often than not, PPP/PFI projects are not delivered earlier because of the long project design and procurement process (Centre for Public Services, 2001).

Good quality infrastructure is essential for economic growth, sustainable development and community well being. And it needs to be maintained and renewed – repairs and improvement backlogs are the result of the folly of public spending cuts in the past.

More PPP/PFI projects now means that public bodies are increasingly ring-fencing revenue budget commitments to the private sector in the future. There are often affordability problems which result in cuts in existing services. The private sector 'invests' in SSP projects by front loading investment but the public sector pays for this investment in regular payments over the contract period.

Off balance sheet: In 2003 the Treasury announced that 57% of PFI investment was 'on balance sheet' although none of the PFI capital spending has been included in the Treasury's calculation of public sector net debt (Office of National Statistics quoted in IFS, 2006). The A$107 billion (£42.7 billion) capital spending on PPP/PFI deals signed by the end of 2004 would, if financed conventionally through the public sector, have increased national net debt by 3.4% that year (ibid).

In October 2006 national Statistics finally released a paper justifying a A$12.9bn (£4.95bn) finance lease liability for PPP/PFI projects which increases public sector net debt by 0.4% to A$1,103.7bn (£4.5bn) (National Statistics, 2006). This figure is only 11% of the A$120bn (£46bn) PPP/PFI capital commitment at March 2006.

The government has used accounting rules to ensure virtually all public sector PPP/PFI commitments continue off balance sheet. All the design and construction costs are funded by the private sector and do not appear on the public sector balance sheet. The public sector become the economic owner (and only becomes the legal owner at the end of the contract) once the project is operational and it starts paying a unitary charge to the PPP/PFI consortia for availability and FM services. But the outstanding availability fee reduces over time as the public body pays the annual availability payments. Once a project is operational the public sector is considered to have entered into a finance lease – an obligation to pay lease payments in the future for assets that are economically owned by the public sector.

So the cost of the project does not appear as a public sector debt until a project is operational and once it appears it starts reducing as payments are made.

A finance lease is different from the capital value of a project. It is usually much smaller because a finance lease relates only to assets judged to be on the public sector balance sheet and does not include contingent liabilities.

The collapse of Enron and several other major company crises which featured off-balance sheet accounting should serve as a reminder of the potential consequences of financial massaging of accounts and questionable accountancy practices.

National assets: The public sector is paying, through the Unitary Charge (consisting of an availability or use element reflecting the capital and related costs plus the charge for facilities management services), for assets it may never own because a new PPP/PFI project will be launched on termination of the existing contract. The National Asset Register identifies the assets of central government, public corporations, NHS bodies and non-departmental public bodies (but excluding local authorities) which had A$585 billion (£274 billion) assets in March 2000 comprising land, buildings, equipment, intangible assets and investments (HM Treasury, 2001).

The Department of Health had A$63 billion (£25.1 billion) assets of which A$40.5 billion (£16.2 billion) were buildings (excluding land). But with A$16.5 billion (£6.6 billion) of signed PPP/PFI health projects plus several large schemes in the planning and procurement stage this represents a significant proportion of public sector health assets. It is not clear whether all or some PPP/PFI projects are included in the National Asset Register. PPP/PFI projects are expected to exceed A$187.5 billion (£75 billion) by 2010/11. The continuation of PPP/PFI could lead to a significant reduction in the net value of public sector assets.

Affordability: The long term nature of PPP/PFI contracts and legally binding financial obligations means that the government is not only imposing financial commitments on future generations but is reducing their flexibility and options. The need for cuts and restructuring have to be focused on a declining number of non-PPP/PFI facilities and services.

Depite significant increases in NHS spending, many NHS Trusts recorded deficits totaling over A$1,300m (£500m) in 2005/06. An Audit Commission investigation concluded that PPP/PFI projects were one of the causes of deficits:

> *"We noted a marked correlation between the presence of a large building project, whether based on incremental growth of a hospital or a big bang approach to renewal via a PFI scheme, and a trust's decline into financial failure"* (Audit Commission, 2006).

This was due to the additional burden placed on senior management during the planning, designing and funding processes. The Audit Commission also found evidence of NHS Trust Boards giving priority to capital projects above the day-to-day running of the trust and the issues they were facing.

> *"We also found recently completed capital building projects being blamed for driving unaffordable long term expenditure levels, although this should be considered as part of the outline business case for the project. The attraction of the big building project, both to local NHS management and across the wider community, makes it difficult to withdraw from negotiations or reshape the vision once strategic approval has been gained and detailed discussions are underway. This carries a clear risk of commitment to spending levels based on optimistic future income assumptions, ambitious savings arising from improved operational efficiency, or both"* (ibid).

Public bodies also incur additional costs after PPP/PFI contracts have been signed with a consequent impact on revenue budgets and other services. They include the cost of renegotiating PPP/PFI projects which have delivery problems and the cost of legal, financial and/or technical consultants. For example, the Criminal Records Bureau PPP/PFI contract with Capita Group plc was signed in August 2000 for A$650m (£250m) but costs have soared to £400m following its renegotiation in December 2003. The Home Department spent A$5.2m (£2m) and A$3.4m (£1.3m) respectively on six and eight PPP/PFI consultancy firms in 2002/03 and 2003/04 (Hansard, 2005). Refinancing PPP/PFI projects also imposes additional costs, or reduces the public sector share of gains. For example, the refinancing of the Darent Valley Hospital cost the NHS Trust A$0.8m (£0.3m) in consultancy fees (NAO, 2005).

Value for money unproven

An evaluation of European Investment Bank (owned by European Union (EU) member states) financed PPP projects, concluded that it was not possible, despite the resources of the Bank, to verify that PPP/PFIs deliver value for money. The Bank has financed a number of PFI projects in Britain and is now one of the largest individual lenders to PPPs, by volume, in the European Union funding schemes in twelve other EU countries as well as China and South Africa.

> *"A Public Sector Comparator (PSC) is intended to answer this question ex-ante but, ex-post, the evaluation could not quantitatively answer the question with an acceptable degree of certainty. The complexity of modelling the ex-post outcomes of the alternatives available ex-ante put this approach beyond the scope of the evaluation. Similarly, despite the EIB's large and diverse project portfolio, it was not possible to identify suitable project pairs to make a direct comparison. Under these circumstances, EV was unable to determine ex-post if the original decision to use a PPP was more cost-effective or not."* (EIB, 2005)

Despite claims to the contrary, value for money in PPP/PFI projects in Britain has not been proven because:

- The use of narrow value for money criteria and sometimes spurious claims for community benefits (for example, road accident and crime reduction benefits in PPP/PFI street lighting contracts, (Centre for Public Services, 2001)
- Contrived Public Sector Comparators often inflate risk transfer by comparing future private sector performance with historic or current performance rather than potential future public sector performance. Historic public sector construction delays, cost overruns and the quality of facilities management are used to inflate risk transfer and justify PPP/PFI projects .

- Evidence of previous public sector construction delays and cost overruns on some major projects, in which private construction companies were 'partners', are used to justify the assumption of similar performance for future projects, large or small.
- Public audit investigations of PPP/PFI projects and the privatisation of public assets carried out by the National Audit Office have been limited in scope and failed to address the wider and long term implications of the PPP/PFI programme (Whitfield, 2001).
- Surveys of PPP/PFI client and project managers, consultants and contractors are claimed to prove the 'success' of PPP/PFI projects but they are based on the views of those with a vested interest and lack of objectivity (NAO, 2003 and PartershipsUK, 2006).
- PPP/PFI are shrouded in secrecy and 'commercial confidentiality' which severely limit the availability of evidence. For example, eleven of the refinanced PPP/PFI projects did not provide any information to the National Audit Office investigation and a further three supplied incomplete information (NAO, 2006).

Further erosion of democratic accountability and transparency

The continued expansion of PPP/PFI and SSP projects is contributing significantly to the erosion of democratic accountability and transparency. Whilst participation and accountability need to be improved in the procurement process, emphasis must be placed on opening up the investment planning and options appraisal processes to democratic accountability. It is in these stages where the decisions and commitments to PPP/PFI and SSP projects are made. These issues are more fully discussed in Chapter 6.

Reduced capacity of public sector

The wide use of management consultants, financial advisers, lawyers and technical consultants for PPP/PFI projects, SSPs and framework agreements results in the loss of public sector intellectual knowledge. This is happening because:

- Consultants are frequently used in all stages from preparation of the Business Case through procurement and evaluation to implementation.
- The complexity of PPP/PFI projects, particularly the financial and legal arrangements.
- Increasing reliance on consultants to design evaluation frameworks and criteria and assist in the evaluation process to demonstrate 'rigor' and 'independence'
- The level of knowledge transfer and capacity building requirements built into contracts is minimal.
- Good quality public sector staff are poached by consultants making public sector recruitment more difficult.

Local and regional economy strategies highlight the importance of the 'knowledge economy'. However, this is frequently not additional knowledge but the transfer of existing public knowledge to the private sector which then recharges the public sector having already been paid to gain access to that knowledge.

Commercialising the community use of schools

The private sector perceives schools as commercial centres to generate additional third party income (for example Newcastle City Council BSF Bids in 2005). Most PPP/PFI consortia refer to business and corporate use of schools and this is likely to result in the marginalisation of community and social uses. Just when schools finally have the potential to become true multi-purpose centres in the community, financial and operational issues become more complex and rely more heavily on the private sector. Some contractors propose setting up special companies to manage the use of school premises to manage the use of schools and to share profits.

Decline of in-house delivery organisations

To date the vast majority of PPP/PFI projects include support services which has the effect of slowly reducing in-house provision of these services and threatens the viability of Direct Service Organisations (DSOs) (ADLO, 1999). The trend towards larger PPP/PFI projects such as the Building Schools for the Future programme creates opportunities for the private sector to bid to supply support services across the entire education estate, which further exacerbate this situation. For example, the BSF guidelines and the procurement process enable local authorities

or PPP/PFI consortia to propose that they takeover facilities management for the entire school estate and possibly the local authority as a whole (DfES, 2004).

Five SSP projects have seconded rather than transferred staff and an increasing number of local authorities require secondment as a mandatory option. However, the authority must be committed to secondment as it is marginally more expensive because of human resource costs, and many private contractors believe their long-term interests are best served by a staff transfer and price accordingly.

The loss of responsibility for design and planning of infrastructure projects and facilities management not only reduces the viability of in-house delivery but reduces their experience of project management and operating front-line services.

Decline in public sector employment

The impact of PPP/PFI on jobs, terms and conditions is examined in Chapter 6. There are almost certain to be longer-term implications for trade union organisation. Increased contracting will fragment staff into separate contracts operated by different companies (and in some cases voluntary sector organisations). The differences in services, type and length of contracts and employers terms and conditions will make collective negotiations and action more difficult. Contractors usually recognise or negotiate only with representatives of their own workforce or regional/national union officers thus marginalising the role of trade union branches where branch officials are not directly employed by the contractor.

Public organisations are likely to have greater difficulty in achieving the implementation of corporate employment policies. The erosion of public service ethos would also seem to be inevitable (Hebson et al, 2002).

Impact on local/regional economy

PPP/PFI projects dominated by national and international contractors could accelerate the trend towards greater international sourcing of building materials, supplies and furniture and fixtures. This would make it more difficult to establish local/regional production and supply chains for materials, supplies, furniture and equipment which are a key part of a sustainable development strategy and support for the local economy and employment. Increased use of migrant labour is also likely as contractors maximise opportunities to employ workers at minimum rates and reduce other terms and conditions such as pensions, holidays and sick pay.

Bigger private sector role in development and regeneration

A combination of PPP/PFI projects, sale and leaseback schemes and the continued privatisation and marketisation of public services will mean that the public sector has a much reduced role in infrastructure provision. It will own fewer and fewer buildings which could spell the end of civic architecture as public bodies simply rent space from the private sector in commercial office buildings. Today's stock of civic buildings will be recycled and redeveloped leaving only the historic town halls. An increasing proportion of the infrastructure of towns and cities will be under private management with long-term contracts**.**

The development of a new PPP/PFI housing/regeneration model was noted above. It could supplement the existing role of Urban Regeneration Companies (URCs), 22 have been established to takeover development coordination responsibility from local government (Whitfield, 2006a). The focus on asset management, property investment trusts (plus new Real Estate Investment Trusts in Britain) and property development related to infrastructure projects could reduce even further the power of local authorities to regulate market forces.

The private sector will have a vested financial and operational interest in the current and future level and location of buildings and facilities. This will make local and city planning more difficult because a new set of constraints will be imposed on the location and type of facilities and services.

Growth of corporate welfare complex

A four-part 'corporate welfare complex' is emerging consisting of a contract services system with a shared client/contractor ideology, contract culture, value system and vested interests in which the state outsources/privatises an increasing range of services and functions; an owner-operator infrastructure industry consisting of the major financial institutions, construction companies, facilities management companies and PFI advisers from a continunal stream of DBFO projects and the acquisition of project via refinancing on the secondary market; a system of regulatory and

financial concessions to business such tax relief, public subsidies, local and regional grants; and the corporatisation of public bodies and business involvement in public policy making (Whitfield, 2001 and 2002).

Increasing pensions investment in infrastructure

Public sector pension funds are already invested in private contractors and companies at the heart of the privatisation and marketisation of public services, including PPP/PFI firms. This is not new, public sector pension funds had significant share stakes in many of the private contractors bidding for local authority and NHS contracts since the start of competitive tendering by the Thatcher Government in 1980 (NUPE, 1982).

For example, the local authority Tyne and Wear Pension Fund employs eight external investment fund managers over 13 investment mandates with a total A$6.75 (£2.7 billion) investment (Tyne and Wear Pension Fund, 2005). They include Legal and General, Capital, UBS, Fidelity, Schroder and Prudential with 65% of funds invested in UK, European, US, Japanese and Global equities. They will inevitably include most of the major firms in the PPP/PFI sector. The further embedding of public sector pension funds in these companies makes any counter action increasingly difficult because of the potential threat to pension fund returns.

Pension funds could of course invest directly in government infrastructure bonds should these provide a secure and reliable investment.

Part 4

Refinancing of PPP/PFI projects and growth of a secondary market for PPPs

Introduction

Once an infrastructure project is built and operational, the project risks (such as delays in construction and site difficulties) are no longer relevant. Financial institutions are prepared to refinance projects offering better terms to reflect the lower risks (National Audit Office, 2002). In addition, a secondary market has emerged in which share stakes in PPP/PFI consortia can be bought and sold.

Refinancing PPP/PFI projects

A voluntary code was introduced in 2002, in which the private sector agreed to provide the public sector with 30% of any refinancing gain. However, this was not contractually binding. Refinancing of later private finance initiative projects is on a 50%/50% basis and is an integral part of HM Treasury's "Standardisation of Private Finance Initiative Contracts" which requires the contractor to obtain an authority's consent to refinance a project (HM Treasury, 2005).

Refinancing 12 private finance initiative projects between 1999-2005 resulted in a A$406.5m (£142.6m) gain for private finance initiative consortia, compared to A$68.2m (£27.3m) for the public sector (National Audit Office 2000, 2002, 2004, and 2005). Refinancing enables the private sector to increase the profitability of the private finance initiative over and above the average 15% - 20% return which is built into projects before refinancing. For example Laing sold a 50% stake in UK Highways (operates a section of M40) in October 2004 for A$65.7m (£26.3m) making a 33% profit.

Table 12: **Sharing of gains on refinancing PPP/PFI projects**

Project	Total refinancing gains (NPV) £m	Amount shared with public sector (NPV) £m	% of gain shared with public sector
Norfolk & Norwich Hospital	115.5	33.9	29.3
Bromley Hospital	45.3	14.2	31.3
Darent Valley Hospital	33.4	11.7	35.0
Sub total	194.2	59.8	30.8
14 other projects where gains were shared in accordance with Code	48.2	11.7	24.3
Sub-total	242.4	71.5	29.5
3 projects where no gains were shared	4.8	-	-
Total of 20 completed refinancings since Code came into operation	**247.2**	**71.5**	**28.9**

Source: NAO, 2006

The Treasury has developed a model of a typical hospital project in which the capital costs account for 54% of the total project costs, operating costs 29% and the cost to the public sector

of the private sector taking the risks of constructing and operating the asset over the contract period accounts for 17% of total costs. Since debt finance accounts for about 90% of PPP/PFI project finance with only about 10% equity investment, refinancing can substantially improve the terms of debt finance.

About half of the refinanced projects in the NAO survey also increased borrowing by an average 20%. The reasons for this are:

> *"Increasing borrowings (beyond what is actually required for the project) allows the private sector to accelerate the benefits to their shareholders by enabling them to pay out inflated dividends shortly after refinancing. The private sector companies may find themselves able to borrow more for a variety of reasons, for example; the market has matured; the project has been successful to date; there has been a general fall in market interest rates, the lengthening of the borrowing period. An increase in the project's debt means an increase in termination liabilities for the public sector, and therefore the private sector requires permission from the public sector before it can proceed to increase its borrowings. The Treasury has advised that authorities must carefully consider the balance between the gains which they are to receive and the extra risk which they will accept if they agree to an increase of private sector debt during refinancing"* (NAO, 2006).

Refinancing has also led to the extension of contracts. Three were extended from between 5 and 7 years. The rationale for contract extensions was summarised as:

> *"Contract extensions are perceived to generate future savings (rather than the current gains derived from the sources discussed above). These future savings are assumed on supposition that the cost of the services secured now, by extending the contract, will be cheaper than those which would be available in the future. Contract extensions are closely tied to the gains which can be derived from increasing debt. By extending the contract the private sector is also able to extend the term of their debt and hence they are able to borrow more. For this reason the extension of a contract and the increase of debt often go hand in hand"* (NAO, 2006).

The increase in contract termination liabilities can be significant. The refinancing of the Norfolk and Norwich Hospital increased borrowing from A$500m (£200m) to A$765m (£306m) which increased the termination liabilities for the NHS Trust by A$642m (£257m). The private sector normally increased their rate of return through refinancing. The average rate of return is 14.5% (compared to about 10% on SSP projects) before bid costs are taken into account (HM Treasury, 2003).

Refinancing gain sharing does not apply to toll roads

PPP/PFI toll road projects usually require the concessionaire to accept all the revenue risks so when projects are refinanced there is no sharing of the refinancing gains between PPP/PFI consortia and the public sector. The A$2.6bn (£1bn) M6 Toll motorway in the West Midlands was built by Macquarie Infrastructure Group (Australia) and Autostrade, the Italian motorway operator who later sold its 25% stake to Macquarie, leaving the operator, Midland Expressway, totally owned by Macquarie.

In early 2006, Macquarie agreed with the government to invest A$280m (£112m) in capital, operating and maintenance costs in the M54 Link Road and the M42 slip road which Macquarie believes "will increase traffic on the M6 Toll motorway" (Macquarie Press Release, 24 May 2006). Clearly an investment intended to secure higher toll income and larger profits.

In autumn of the same year, Macquarie paid itself A$1,020m (£392m) in dividends after refinancing the original PPP/PFI project. It did this by increasing the debt of Midland Expressway from A$1.6bn (£620m) to over A$2.6bn (£1bn). The government failed to impose any controls on the level of tolls charged by Macquarie which is expected to undertake further refinancings during the remaining 48 years of the concession and to pay itself further dividends.

Growth of a secondary market

The sheer scale of investment is requiring some construction companies to recycle or sell some of their equity capital in private finance initiative projects in order to bid for new projects.

Several dedicated secondary market investments funds (for example Innisfree/M&G, Henderson Global Investors and the Secondary Market Infrastructure Fund (SMIF)) have been set up to

acquire private finance initiative equity. These funds will normally purchase the entire equity in a project and are planning to build a portfolio of private finance initiative projects. Ownership of prisons, schools and hospitals will transfer from construction company-led consortia to financial investment institutions. This, in turn, is creating new markets for companies undertaking due diligence during the refinancing process and in managing groups of special purpose vehicle companies established for each private finance initiative project (Hazell, 2005).

A survey found that 40% of a sample of 80 projects had a sale of equity and half of those projects had also been subjected to refinancing (NAO, 2006).

Global Solutions was originally established as the bidding vehicle for Group 4's prison and private security projects in the 1990s. When Group 4 merged with Securicor in 2004 the European Commission ruled that Group 4 must sell GSL. It was acquired by a private equity firm, Englefield Capital and Electra Partners, which added healthcare projects to the portfolio. The investment partnership between GSL and SMIF resulted in the £70m sale of GSL's PFI assets to SMIF and the establishment of a A$112.5m (£45m) investment partnership to finance new deals in the UK and Europe. GSL's PFI assets included two prisons, four LIFT projects, two hospitals, the Government's Communications Headquarters (GCHQ) and a schools project.

The Secondary Market Infrastructure Fund (SMIF) was set up by Babcock and Brown and Abbey National in 2001 to target the PFI secondary equity market. Star Capital, HBOS and AMP now have a majority stake in SMIF which has built up over A$1 billion (£400m) of PFI equity stakes in the last two years. These included interests in 18 PFI projects from Jarvis plc, equity in the Newcastle Estate Partnership for A$65m (£26m), a 50% stake in the M40 road concession from John Laing plc for A$65m (£26m), and interests in the Wythenshawe Hospital, Manchester for £15m from WS Atkins and Alfred McAlpine. Carillion, the construction company, sold a portfolio of eight PPP/PFI equity investments to SMIF and another investment trust, Infrastructure Investors, in autumn 2006 netting £22m. It included Fazakerly prison and a Leeds schools project.

Key issues

Refinancing raises a number of important issues:

- Substantial additional profits can be made by the private sector in refinancing PPP/PFI projects and selling equity stakes in projects. This must challenge the value for money assessment of the original PPP/PFI deal.
- The lack of public control over the sale of PPP/PFI consortia share stakes.
- The extent to which financial institutions and the PPP/PFI lobby intend to establish secondary markets in other countries.
- The longer term consequences of a widening investment market in PPP/PFI projects.

Part 5
PPP/PFI performance

Introduction

Following operational surveys and reviews of PPP/PFI performance (for example, Partnerships UK, 2006 and 4ps, 2005) the government concluded that:

> *"……the evidence on satisfaction with soft services does not demonstrate value for money as consistently as other elements of the framework, and ……..that while standards are no worse than in non-PFI structures, PFI has not led to a step change in soft service delivery. Therefore the Government is strengthening its value for money test so that the public authorities must rigorously prove the case for including soft services in PFI projects.*
>
> *……..In future, where the public sector decides to include soft services, the Government will amend the standard PFI contract so that the soft services elements have greater flexibility. This will be achieved by requiring the provision of soft services to be actively competed and market tested at appropriate points during the PFI contract. This will ensure transparency and competition at the point service requirements are reassessed and repriced"* (HM Treasury, 2006a).

Studies of operational PPP/PFI projects have also revealed that "the level of input required for contract monitoring by the public sector was substantially higher than had originally been anticipated. This was both in terms of the local authority team and also with users (eg in schools by school staff). ………and whether this was sustainable over the contract life of 25 years" (Partnerships UK, 2006). This issue was a central feature of Compulsory Competitive Tendering and market testing in the 1990s but the PPP/PFI lobby has always maintained that PPP/PFI was 'different' and this problem would not arise. Outline Business Cases frequently have attributed significantly lower monitoring costs for PPP/PFI projects compared to public provision, another invalid assumption.

A typology of problems

The failure and poor performance of PPP/PFI projects can be grouped into four categories – project structure failure, financial collapse crises in construction companies, poor design and poor operational performance.

Structure of the project

Fundamental problems with the structure of a project could give rise to its termination, renegotiation or refinancing. Five PPP/PFI projects are examined below:

- Skye Bridge, Scotland (contract terminated early to abolish tolls)
- National Physical Laboratory (contract terminated because of construction failure)
- Paddington Basin project (project abandoned before procurement commenced)
- Royal Armouries, Leeds (renegotiated contract because of financial crisis)
- National Air Traffic Services (had to be refinanced)

Failure of construction companies

Three PFI construction companies suffered financial crises in the last four years which led to the sale of PFI assets and bid teams (the Jarvis PFI bid team was sold to the German construction company Hochtief), the sale to a foreign company (Amey sold to Ferrovial, Spain) and one went into administration (Ballast collapsed in 2003 resulting in delays to the refurbishment of 6 secondary schools in East Lothian and renegotiation of a new project with Balfour Beatty).

Design failures

The design of many PFI schools have failed to match the hype. For example, a survey of 60 new and refurbished schools concluded that "some respondents are happy with the finished result

particularly when it is well designed and spacious. Such comments are disappointingly rare." The survey focused on the impact of teacher staff comments on the final school plans (only 27% believed their comments had made an impact) but also included community use of schools and the design and quality of services. (Educational Institute of Scotland (EIS) Survey of New and Refurbished Schools: Report of Findings, May 2004)

Poor operational performance

London Underground PPP

The London Underground was divided into three PPP contracts, two were won by the Metronet consortium (Atkins, Balfour Beatty, Bombardier Transportation, EDF Energy and Thames Water) and the third by Tube Lines (Amey and Bechtel). Performance in the third year of the contract was very mixed. Only one contract, Metronet SSL, achieved better than benchmark availability scores for all lines, although there was a deterioration of 12% in agreed lost customer hours (Transport for London, 2006). Ambience (the quality of the travelling environment) improved in two contracts but deteriorated in the Metronet BCV contract.

Metronet's track maintenance performance "has been particularly poor, leading to regulatory action" (ibid). Table 13 shows Metronet;s poor track and station renewal performance. The consortia "has spent broadly in line with its bids but has delivered significantly less renewal………..that unit rates for delivering this work have been higher than expected in the bid" (Office of the PPP Arbiter, 2006). This could have major implications for investment in future years.

Table 13: **London Underground PPP – Metronet performance to 31 March 2006**

Track and station renewals	BCV contract		SSL contract	
	Bid offer	Actual	Bid offer	Actual
Stations modernisations/ refurbishments	17	4	18	10
Ballasted track renewals	19.0 km	22.2 km	30.1 km	12.7 km
Deep tube reconditioning	18.7 km	9.1 km	-	-
Expenditure				
Stations modernisations/ refurbishments	N/a	N/a	£2.0m/ station	£7.5m/ station
Ballasted track renewals	£1.5m/km	£1.8m/km	£1.6m/km	£3.2m/km
Deep tube reconditioning	£3.0m/km	£5.7m/km	-	-

Source: Office of the PPP Arbiter, 2006

The performance of PPP/PFI information and communications technology projects in the 1996-2006 period is summarised in ESSU, 2007.

Audit Commission and Audit Scotland schools findings

A study by Audit Scotland of 6 of the 12 operational PFI projects (covering 65 schools) in Scotland revealed:

- In 5 of the 6 cases the PFI construction costs were higher than for the Public Sector Comparator (PSC).
- In all 6 cases the operating costs of the PFI option were higher than the PSC.
- Financing costs made up one quarter of the total costs of the projects.
- The overall financing costs for the private sector were between 2.5% and 4% higher than a council would pay if it borrowed money itself for a similar project (Audit Scotland, 2002).

An Audit Commission study in England compared 17 PFI schools with 12 recently, traditionally funded schools and found:

- The quality of the PFI schools was not as good as schools built by more traditional means;
- The best examples of innovation came from traditional schools;
- The costs of cleaning and caretaking appeared to be higher in PFI schools;

- New-Build PFI schools were not completed more quickly (Audit Commission, 2003).

There have been a series of problems in PPP/PFI schools, for example, financial deductions for non-availability and poor performance in Sheffield, Haringey, Falkirk, Edinburgh, Cornwall, Glasgow and Renfrewshire.

Structural failure of PPP/PFI projects

Skye Bridge PFI bought out to end tolls

The Skye Bridge was one of the first PFI projects in Britain - the contract was signed in December 1991 (consortia of Miller Construction, the German construction firm Dyckerhoff and Widmann AG and Bank of America) and opened in 1995. The existing ferry service was closed at the same time. A vociferous community campaign protested at the high toll fees. The Scottish Executive made a 50% reduction in discounted tolls for regular users (cars and motorcycles) and 25% for commercial and public service vehicles from January 1998. In 1999 Scottish Ministers made a commitment to freeze Skye tolls at 1999 prices for the remainder of the concession period.

The original deal required the Scottish Office to pay A$30m (£12m) to Skye Bridge Ltd (for constructing the approach roads and compensation for the cost of design changes and delay following a public inquiry, plus A$7.5m (£3m) advisers and related fees. The agreement required the company to receive A$60m (£24m) in toll fees plus A$7.5m (£3m) compensation for the reduction in discounted tolls over the concession period. A House of Commons Public Accounts Committee investigation in 1998 revealed that no public sector comparator had been prepared. It expressed concern about the terms on which the bridge had been provided and the 18.4% rate of return to equity investors (PAC, 1998).

Following a European Court of Justice ruling in 2000 that VAT had to be levied on road, bridge and tunnel tolls operated by private companies, the Scottish Office negotiated another variation order agreeing to pay compensation to the Skye Bridge Company for the amount of VAT payable by the company (Scottish Office, 2002). Then in December 2004 the Skye tolls were finally abolished. Skye Bridge Ltd is expected to receive a lump sum of about A$67.5m (£27m) to terminate the concession (Scottish Office, 2004).

National Physical Laboratory PFI project terminated

The private sector lost at least A$250m (£100m) on the PPP/PFI project for the National Physical Laboratory which was terminated in 2004 after long construction delays (between 7 and 46 months for different phases) and failure to meet the required specification. The buildings required stringent temperature and sub-audible noise controls but problems arose in achieving the specification in 30 key laboratories. According to the NAO "The fundamental reason for the termination was that the original private sector design of the new buildings was deficient" (NAO, 2006).

The Department of Trade and Industry paid A$187.5 (£75m) to the PFI consortia for the work completed and undertook to complete the construction work in 2007, six years behind schedule. The PFI consortia was headed by Serco Group plc and John Laing plc and financed by the Bank of America and Abbey National.

Laing's 'seriously underestimated the cost of constructing the buildings and lost £67m on the contract" A further £12m losses were borne by sub-contractors. Serco and Laings lost expected dividends of £4m and the banks lost £18m (ibid).

The collapse of the Paddington Health Campus project

This is a story of a grandiose project, poor governance and project management, NHS marketisation policies undermining the affordability and financial security required for long-term projects, and a property developer seeking to exploit the public sector. Partnerships UK were a partner and several government reviews and investigations were carried out before the project was finally abandoned in 2005 prior to the start of procurement.

The Paddington Health Campus project was designed to replace three old hospitals – St Mary's, the Royal Brompton and Harefield including new research facilities for Imperial College, including the National Heart and Lung Institute. The project started with 1,000 beds but this increased to 1,200 within two years, then fell to 1,088 and finally to 835 NHS beds and 88 private beds. An Outline Business Case estimated gross construction costs of A$750m (£300m), was approved by the London Regional Office of the NHS in October 2000. By May 2005 when the project was abandoned, costs had risen in a revised OBC to A$2,245m (£894m). Some A$37.5m (£14.9m) of

public money was wasted in project and consultancy costs. The NAO noted that the opportunity cost would have been greater, a 17 month delay would have added over A$260m (£100m) to construction costs, which rise faster than the rate of general inflation.

The main reasons why the project collapsed were:

- The lack of a single project sponsor – there were three campus partners, St Mary's NHS Trust, Royal Brompton and Harefield NHS Trust and Imperial College. Partnerships UK, the privatised Treasury PFI unit, became a partner in 2002. The Royal Brompton and Harefield trust were partners on condition that there was no merger with St Mary's.
- The NHS failed to secure adequate land for the scheme before the OBC was approved in 2000. The developer of the Paddington Basin, Paddington Development Corporation Limited (PDCL - Chelsfield property) wanted a A$156.2m (£62.5m) premium over open market value for additional land for the project.
- Project decision making was also distorted by the requirement that the OBC and the cost of additional land had to be off balance sheet – neither the Department of Health nor the Trusts could afford to put the funding on their own balance sheets.
- Adequate funding for the project was never secured – early 2003 the funding gap between available revenue and the expected running costs of the scheme had risen to A$133m (£53m). Constantly changing revenue forecasts undermined confidence which ultimately led to the North West Strategic Health Authority and the Royal Brompton Trust refusing to support the May 2005 OBC.
- The project did not have an adequate risk strategy until late 2004 because of a lack of resources and capacity. This was a "key contributor to the Campus partners' collective inability to realise fully and act earlier on the threats to the viability of the scheme" (National Audit Office, 2006).

The government's strategy of marketising the NHS, which began after the OBC was approved, through patient choice, payment by results (money following patients) and the transfer of care away from acute hospitals to the primary care sector makes it very difficult to forecast long-term funding required for PFI projects and thus affordability.

Restructuring of Royal Armouries PPP/PFI project

The Royal Armouries moved from the Tower of London to a new museum in Leeds in 1996. The A$108m (£43m) PPP/PFI deal with Royal Armouries International (RAI - led by 3i Group plc,) included A$50m (£20m) from the museum and A$21.2m (£8.5m) from Leeds City Council and Leeds Development Corporation. The Armouries financial advisers, Schroders, forecast 1.3m visitors per annum based on PA Consulting and MORI projections which would have given investors a 25% rate of return over 25 years.

However, visitor numbers peaked at 344,000 in 1997 and plummeted to 191,000 within two years. RAI refinanced the deal twice but cumulative losses soared to A$25m (£10m) in 1999 and the Bank of Scotland refused further lending thus forcing a renegotiation of the contract. The Armouries took over the running of the museum whilst RAI retained responsibility for some services. Although it was an early PPP/PFI deal and the National Audit Office identified a number of issues, the core problem was the wildly optimistic visitor forecasts and a delay to the redevelopment of the adjacent docks which was expected to boost visitor numbers (NAO, 2001). UNISON concluded that:

> *"Under the contract revision, the main risk allocated to the private sector (the 'demand risk' of adequate customer numbers) was transferred back to the public sector whilst shareholders, who should have lost their investment when the contract failed through lack of cash, were substantially protected. These changes were achieved by shifting responsibility for the new museum to the Royal Armouries whilst RAI was allowed to retain profit-making activities such as catering, car parks, and corporate hospitality, giving shareholders a chance of profit even though the venture had failed and under the original agreement they should have lost their money*" (UNISON, 2004).

The project ceased to be a PPP/PFI project in 1999 following the renegotiation of the contract.

National Air Traffic Control PPP refinanced

National Air Traffic Services (NATS) was owned by the Civil Aviation Authority and operated air traffic control in Britain. In 1997 it estimated that it needed an annual £100m capital investment to increase air control capacity. The government decided that privatisation via a PPP was the best option and NATS was privatised in July 2001. The Airline Group, a consortium of seven UK based airlines (BA, Airtours, British Midland, Britannia, Easyjet, Monarch and Virgin) obtained a 46% share in NATS for A$2,000m (£800m) (NAO, 2002).

However, the airline industry suffered a downtown after September 11th 2001 which forced a refinancing of NATS in 2003 – basically the company's financial position was not strong enough to continue with capital investment and the airline group was unwilling or unable to invest additional funds. The four banks which funded the airline group did not want to change the structure of the PPP. After refinancing BAA plc, the owner of major airports and itself privatised in 1987, became a new investor with A$12.5m (£5m) of share capital and a A$150m (£60m) loan to NATS. The government also invested the same amount. The original PPP and refinancing deal cost A$187.5m (£75m) in advisers fees (NAO, 2004).

BAA plc was acquired by the Spanish construction group Ferrovial in June 2006, the same company that acquired Amey plc in its financial crisis in 2002/03.

Sale and lease-back of government offices

The New Labour government, keen to establish a market in the sale and lease-back of government buildings, announced a A$9 billion (£3.6 billion) private finance initiative deal with Mapeley Group in March 2001. It included 700 buildings of the Inland Revenue, HM Customs and Excise, and the Valuation Office Agency in the Strategic Transfer of the Estate to the Private Sector (STEPS) project. It was similar to an earlier private finance initiative project by the Department of Work and Pensions for the Newcastle Estate. Under sale and lease-back, the state sells buildings that are maintained by private sector property management companies for 21 years, who then find other tenants/uses.

Mapeley immediately transferred the freehold and long-lease properties to Bermuda. Mapeley is owned by Fortress Investment Group, USA, Soros Real Estate, Netherlands and Delancy East Ltd, UK, but it is now based offshore in Bermuda. The Strategic Transfer of the Estate to the Private Sector is expected to save A$860m (£344m) over the 20-year contract period. However, Mapeley estimated that it would have had to increase its bid price by A$137.5 (£55m) to bring the STEPS properties onshore: in other words, the Inland Revenue lost A$137.5m (£55m) income because of the deal. But the shareholders of Mapeley are non-UK resident and do not have to pay UK capital gains if they sell their shareholdings – this is a potential additional loss of income for Inland Revenue. Inland Revenue knew about the offshore plan during preferred bidder negotiations, but HM Customs and Excise were not informed until after the contract was signed!

Seven months into the contract, Mapeley demanded more money based on errors in pricing its bid and the level of contract variations, and claimed an annual shortfall of A$67.5m (£27m). Mapeley's bid was some A$1,250m (£500m) lower than two other bids. The Departments refused to pay and the firm's shareholders injected additional finance. Four years into the contract the performance management system had still not been agreed. By April 2004 the Departments had spent an additional A$32.5m (£13m) on consultants for the STEPS project.

Yet the National Audit Office made no comment on the offshore aspects of the deal except that the A$137.5m (£55m) was "not material". However, they did recognise that the STEPS business model "has a high degree of fixed costs and is therefore very sensitive to any future shortfalls in forecast income". Civil servants appearing before the Committee of Public Accounts could not give any assurances on whether the A$860m (£344m) savings will be achieved or not. Despite all the pitfalls with this project, the National Audit Office claimed that "STEPS had demonstrated a number of benefits both for departments and for bidders, for example, reduced costs and a more attractive portfolio of properties" (National Audit Office, 2004). The evidence shows only that it may have reduced costs in the first four years of a twenty-year contract. The only certainty is that the private sector gets an 'attractive portfolio of properties' from such deals.

The poor track record of PPP/PFI ICT contracts

Before the government halted the use of PPP/PFI for ICT contracts in July 2003 there were a series of high profile delays and massive cost overruns. For example, three criminal justice system projects had a combined cost increase of A$670m (£268m) or 79% (Justice Forum, 2002), and projects in the Passport Office, Metropolitan Police, National Air Traffic Services, Immigration and Nationality, National Insurance plus revenues and benefits projects in several local authorities

experienced delays, overspending and contract terminations. Delays, cost overruns, and contract terminations have been identified in 100 private sector contracts to deliver public sector ICT projects, many of which are PPP/PFI projects (ESSU, 2007).

Strategic Service-delivery Partnership (SSP) performance

Bedfordshire County Council

HBS Business Services Group commenced a 12-year A$667.5m (£267m) Strategic Service-Delivery Partnership (SSP) covering financial, information technology, human resources, school support services and contracts/facilities management in June 2001. Some 550 County Council staff transferred to HBS under the Transfer of Undertakings Regulations (TUPE). HBS Business Services Group Ltd, is privately owned by Terra Firma, a group of equity investors with interests in hotels, waste, housing and property in Germany, who invested A$250m (£100m) in HBS which at one time was the market leader in SSP projects.

Bedfordshire UNISON commissioned the Centre for Public Services to evaluate the strategic partnership which revealed that it was in crisis and had failed to deliver many of the contractual commitments such as improved performance, improved training provision and a regional business centre, (CPS, 2005). The Conservative controlled County Council terminated the contract in August 2005 with staff transferring back to the County Council (see www.european-services-strategy.org.uk/outsourcinglibrary for a copy of the UNISON report and termination agreement).

West Berkshire Council

The Council terminated a ten-year A$420m (£168m) strategic partnership with Amey plc after just three years in June 2005. The contract included ICT, procurement, financial, human resources, property and other services, Four hundred staff were transferred back to the council. In a joint statement, the Council Leader described it as an “amicable settlement” and “the time is right to draw it to a close.” Amey’s Group Director for Strategic Development stated that “the original objectives for the Partnership, set by both the Council and Amey, cannot easily be realised” (West Berkshire Council, 2005) . The Council will run the Customer Service Centre established by Amey and will continue the modernisation programme with a A$7.5m (£3m) payment from Amey. A special meeting of the Council agreed to increase the training budget and transfer the Amey West Berkshire Pension Fund to the Council’s Pension Fund (ibid).

Redcar and Cleveland Council

Following a 'strategic review of services' by Redcar and Cleveland Council, HR and Payroll, Finance and Accounting, ICT, Public Access and Business support will be brought back in-house by September 2006 after only 3 years of the 10 year contract with Liberata (Redcar and Cleveland Council, 2006). Only 120 of 650 staff will be retained by the company to provide Council Tax, Housing Benefits and the contact centre.

London Borough of Southwark – WS Atkins

The A$250m (£100m) contract to operate the LEA was terminated after two years of the five year contract. Atkins failed to meet several key targets and claimed the contract was ‘unprofitable’ (UNISON, 2003). The contract termination cost Southwark Council A$3.75m (£1.5m).

Conclusion

These examples of PPP/PFI failures demonstrate how grandiose schemes and the need for off balance sheet finance can ignore basic issues of affordability. Poor design and planning can result in significant financial losses to both the public and private sector. High tolls and user charges will be opposed and ultimately result in higher public sector costs. Attempts to maintain national ownership of the infrastructure can collapse when investors are vulnerable to foreign takeovers and mergers.

All the above projects were structured on high rates of return to private investors although the National Audit Office remained quiet on this matter. It is also significant that PPP/PFI guarantees very high levels of fees to advisers and consultants irrespective of their performance and the subsequent performance of the contract. Consultants who advocate and promote risk transfer bear few of the risks themselves.

Part 6

Democratic accountability and transparency

Introduction

The planning and implementation of PPP/PFI projects have contributed to the erosion of democratic accountability and transparency. This chapter provides a brief overview of some of the key issues in the six stages of PPP/PFI projects - project planning and approval, design, procurement process, operation and management, scrutiny and review including market testing of soft services and refinancing and sale of equity in projects.

Erosion of accountability

PPP/PFI has resulted in the erosion of democratic accountability in many different ways.

User/community organisation and staff/trade union consultation and involvement in the planning, business case and procurement processes is normally very limited. In the vast majority of cases reviewed for this study, stakeholder involvement is limited to users being consulted about the design of building and spaces and employees being consulted on the employment implications of bidders proposals. In neither case are they involved or consulted on the planning and structure of the project, financial arrangements, shortlisting of bidders or evaluation of bids.

Frequently, management and consultants examine the options and prepare a business case which is then presented as the only viable option. Elected Members, parents, governors, teachers, community organisations, trade unions are basically presented with a fait accompli and told it is PPP/PFI or nothing. So participation begins at the stage when the PPP/PFI option has been 'selected' and consultation is often limited to the design and procuring the best contractor/bid. This participation is then claimed to demonstrate support for the PPP/PFI project.

Trade union involvement in the procurement process is usually limited to employment and transfer matters and meetings with the bidders to discuss more precise details of their policies and practices as part of the selection process.

SSP projects often involve staff at an earlier stage which will include site visits and a process of more detailed engagement, mainly because these projects involve many skilled staff required to deliver corporate services. SSP projects are more staff centred projects compared to PPP/PFI infrastructure projects and neither the public sector body or contractors can afford to alienate the staff who will be at the centre of a transformation process. However, because SSPs focus on corporate or 'back office' services, consultation is usually limited to internal consultation associated with Best Value reviews and/or staff forums.

The lack of information about PPP/PFI is a common problem, much of which is treated as 'commercially confidential' and is exempt from Freedom of Information on the same grounds. Furthermore, confidentiality makes comparisons between public and private sector performance almost impossible and meaningless because the precise quality and level of service, staffing levels, pay and conditions and other factors which determine performance is more difficult to obtain from privately operated contracts. This has implications for the benchmarking of facilities management contracts in PPP/PFI projects in terms of who is able to ensure rigorous and genuine analysis and comparison with similar contracts.

The technical nature and complexity of projects imposes constraints on participation. Complex financial, legal and technical negotiations mean that many community representatives are excluded, partly by the complexity of issues and partly because it is impractical for them to engage in full time negotiations extending over several months. The situation effectively increases the power of advisers and weakens accountability.

Partnership Boards, particularly in SSP projects, comprise senior elected members and senior management from the local authority, together with directors and contract managers from the contractor, report direct to the Council's executive or cabinet. Reports and minutes of Partnership

Boards are either never published or are very difficult to find. Backbench elected members in SSP authorities frequently know little of what is reported or discussed at Board meetings.

The new PFI models – BSF and LIFT – and SSP projects place private sector corporate interests in the heart of local government and other public bodies. This is done in the name of 'partnership' but with virtually no debate about the effect on accountability, of "accountability being detached from the political process" (Woodhouse, 2005) or the longer term consequences of a multiplicity of boards within local government or other public bodies. The public interest and the public service ethos appear to be expendable in the effort to 'modernise'.

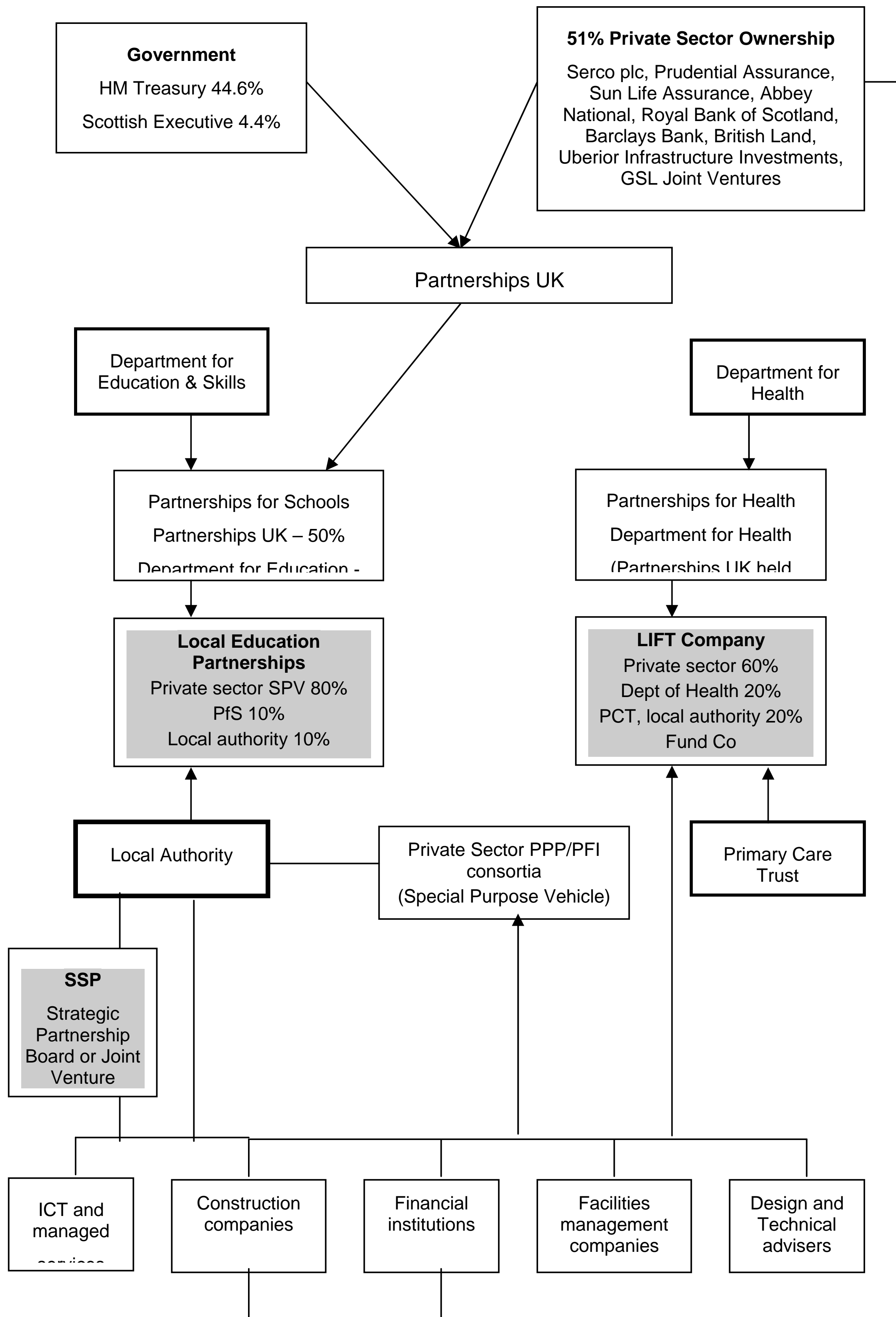
Stakeholder **Strategic Partnership Boards** are a key part of the organisational structure in BSF and LIFT projects and are intended to have wide local representation. However, it is common practice that they are not established until after the procurement process and are limited to advising on future implementation.

The Treasury taskforce on the private finance initiative, Partnerships UK PLC, was privatised by Labour in March 2001 via a 51% sale of shares. The Treasury and the Scottish Executive retain a minority holding of 44.6% and 4.4% respectively. Investors include private contractors Serco, Prudential Assurance, Sun Life Assurance, Abbey National, Royal Bank of Scotland, Barclays Bank, British Land, Uberior Infrastructure Investments, and GSL Joint Ventures have share stakes of between 8.8% and 2.2%. Partnerships UK has a stake in Partnerships for Schools and Partnerships for Health.

Organisational structure

Figure 3 illustrates the organisational structure of BSF, LIFT and an SSP in a local authority. Most large local authorities already, or will soon, have BSF and LIFT private companies and some also have a Strategic Partnership Board or Joint Venture Company for a SSP project.

Figure 3: **Organisational structure for Building Schools for the Future (BSF) and Local Improvement Finance Trust (LIFT) PPP/PFI projects in Britain**



The secondary market operates outside of democratic control. PPP/PFI consortia can sell their PFI shareholdings whenever they choose in the same way as contractors and consultants can be taken over and merged, often by foreign companies. Public sector organisations are required to sanction the refinancing of projects but they are in effect lame ducks. The vast majority of public sector organisations are going to say 'yes' because they will gain financially, no matter how small and irrespective of whether it is equitable.

Transparency without accountability

The government claims to have addressed some of the transparency issues and *"has introduced a number of reforms that have significantly increased the transparency of PFI and improved accountability for service users and service providers"* (HM Treasury, 2006a). These have included:

- an estimate of future payments contracted for by each PFI scheme is published biannually in the Financial Statement and Budget Report, and the Pre-Budget Report;
- the capital value of contracts signed to date and in procurement is published in the Financial Statement and Budget Report, and the Pre-Budget Report;
- an annual record of signed deals committed to in the previous year is published on the Treasury's website; and
- a published summary of the PFI pipeline by department.

The Treasury intends to improve further overall accountability and transparency, by encouraging all departments to follow the example of the Department of Health so that the outline business case for projects will be published on the website of the procuring authority within three months of final approval. It will also ensure that the strategic business case for projects (bar commercially confidential information) will be published on the website of the procuring authority within three months of financial close.

Furthermore, it intends to 'encourage' all departments to adopt the Department of Health's Code of Practice on Openness in the NHS which requires that procuring authorities publish an executive summary of every PFI project. This includes:

- background details, such as the project specification, investment objectives and the expected timing of key dates;
- project details, such as the total capital cost, the scope of facilities management services included in the contract and details of the consortium partners;
- capacity details, such as demand assumptions and scope for future flexibility;
- staffing/TUPE details, such as the number and timing of any staff being transferred or seconded to the consortium;
- financial details, such as the unitary charge amount and the indexation basis; and
- other key details, such as derogations from the standard contract and the terms allowing deductions from the unitary charge (HM Treasury, 2006a).

Whilst this will facilitate research projects it will do little to improve accountability and transparency of the PPP/PFI process. It will provide basic information which should be available as a matter of public interest which would have to be released under the Freedom of Information legislation. All the information is related to the completion of projects and provides no additional information during the crucial planning, design and procurement processes. The 'spend now, pay later' focus on individual projects means that there is a paucity of information about the longer financial impact on the local authority, NHS Trust or government department budget or on a regional or sector basis.

The emphasis must be on accountability, transparency and the release of information in the planning and identification and appraisal of options before decisions are made rather than releasing information which further justifies a decision to use the PPP/PFI approach.

Part 7
Impact on jobs, terms and conditions

Introduction

The employment impact of PPP/PFI projects is difficult to identify because the labour content varies very widely between projects. There are also differences in the proportion of staff that are transferred from the public to the private sector and newly employed staff. Assuming an average 200 staff transferred in the 750 signed PPP/PFI projects, it is estimated that a total of 150,000 public sector staff have been transferred to the private sector through PPP/PFI.

Employment models

There are basically four employment options or models for PPP/PFI and SSP projects:

- In-house – staff remain public sector employees.
- Secondment – staff remain public sector employees but are managed by a private or voluntary sector provider on a day-to-day basis.
- Outsourcing or contracting out – staff are transferred to a private or voluntary sector employer.
- A ‘mixed economy’ or ‘choice’ version of secondment - staff are transferred to a new employer and are given the ‘choice’ of remaining a transferee or opting to be seconded. Agreed transfer windows during the contract would allow employees who are seconded to transfer to the contractor. This is a more complex option and the level of secondment is likely to reduce considerably over the course of the contract thus undermining its benefits.

Transfer and employment rights in Britain

The transfer of undertaking regulations (TUPE – which implement the European Union 1977 Acquired Rights Directive in Britain) and the Best Value Code of Practice on Workforce Matters are important regulations which afford a degree of protection for jobs, terms and conditions in Britain.

The Best Value Code of Practice on Workforce Matters now applies across the public sector. The Code requires that contractors (and sub-contractors) employ new staff working alongside transferred staff on “fair and reasonable terms and conditions which are overall no less favourable than those of transferred employees.” Contractors must consult with trade unions to agree the terms and conditions for new starters. The Code must be included in the contract between the public sector and the contractor.

There is no comparable transfer and employment rights in Australia.

Pensions are not directly covered by TUPE but the Local Government Act 2003 made the Cabinet Office Statement of Practice Staff Transfers in the Public Sector and its Annexe, A Fair Deal for Staff Pensions, legally binding. Staff will have the right to either the Local Government Pension Scheme (LGPS) or a “broadly comparable pension” scheme approved by the Government’s Actuary Department (GAD). Contractors are required to offer new staff the option to join the Local Government Pension Scheme (LGPS), a good quality pension scheme – either a contracted out final salary based defined benefit scheme or a defined contribution scheme or the employer must match employee contributions up to 6% in a defined contribution scheme or a stakeholder pension scheme.

TUPE Plus

TUPE Plus was developed by several individual UNISON branches to strengthen and extend a contractors obligations following the transfer of staff. TUPE Plus requires a contractor to make a commitment to fair employment policies such as:

- the service provider will not operate a two-tier workforce.

- annual local government pay awards prevail unless otherwise agreed with the recognised trade unions.
- seek admitted body status to the Local Government Pension Scheme so that all TUPE transferred employees have the option of remaining within the local authority pension scheme and there is capacity to add that choice for new staff.
- equal opportunities, work-life balance policies, whistle blowing policies and health and safety.
- staff training and development.
- maintaining trade union recognition for transferred and new staff who must have equal opportunity to join a recognised trade union. Bids should specify the recognition agreements contractors intend to honour and if these are different from those currently in place, explain their reasoning.
- no restrictions on staff promotion, for example, requiring transferred staff to transfer to the employer's own terms and conditions.
- trade union facility time – the new employer will be required to specify the amount and nature of facility time it is proposing.
- check-off – new employer will be required to provide a check-off facility for the deduction of trade union subscriptions.

Exclusion of services

The Government is strengthening its value for money test so that public authorities must rigorously prove the case for including soft services in PFI projects (HM Treasury, 2006a).

Newcastle City Council set a precedent early in 2006 when it decided to exclude soft facilities management services (school meals, cleaning, grounds maintenance, security) and ICT services (A$47.5m (£17m) over five years) from its Building Schools for the Future project following the submission of mandatory bids. The Newcastle upon Tyne Hospitals NHS Trust's A$750m (£300m) PPP/PFI project to extend and refurbish the Royal Victoria and Fleming Hospitals excluded soft FM services, the maintenance of the existing estate, major medical equipment and car park management. Some advisers claimed this would limit competition but this proved not to be the case.

Mandatory bids by in-house services

A local authority could require a mandatory bid by the in-house service/DSO to be submitted for soft services. The OJEU Notice must indicate to tenderers that the in-house service will be submitting a bid for soft services. The bid would be evaluated together with the PFI FM provider bid. Ideally services should be excluded before the procurement process thus eliminating the cost of preparing an in-house bid.

This process has several disadvantages. Firstly, the in-house service will incur additional costs to prepare tenders, which it would not otherwise have to bear. Secondly, it reduces the time available for the in-house service to develop an integrated one-stop-shop supplying not just FM, but a range of educational support services. Thirdly, requiring a tendering process tends to increase the financial bias in the award of contracts. Fourthly, it contradicts the local authority's procurement policy, where the continued provision of a good quality service does not require a procurement process.

Secondment and retention models

There are two secondment models. The first requires all staff within the scope of the contract to be seconded to the contractor with new starters being directly employed by the local authority. The Secondment Agreement sets out the obligations, employment status of the secondees and their management by the contractor.

The second model is the Department of Health Retention of Employment model (RoE) developed for NHS staff in England for NHS Trusts involved in PFI projects covering catering, cleaning,

laundry, security and portering services. Staff remain NHS employees but supervisory and managerial staff are transferred to the private contractor.

Risks borne by staff

The advantage of the secondment model is that it substantially reduces the risks of employment change when staff are transferred when a service is outsourced. TUPE transfers and the Code of Practice do not provide any guarantees so public bodies in effect transfer risk to their existing staff. Pensions are not covered by TUPE. There is considerable change occurring in the pensions sector with private sector employers replacing final salary with money purchase schemes and a growing number of under-funded pension schemes.

Other risks are transferred to staff such as changes to terms and conditions of service, changes to staff consultation and representation, and to workplace conditions.

The Employment Risk Matrix assesses and compares the risks of transfer, secondment and the 'choices' or mixed economy employment model (European Services Strategy Unit, 2006). It shows that 100% of the risks for the secondment model are in the none/low risk category compared to only 20% in the transfer model and 16% in the 'choice' model. The transfer model has 40% of the risk for employees in both the high and medium risk categories - see Table 14.

Table 14: **Summary of Employment Risk Matrix**

Risk level	In-house/Secondment		Transfer		'Choice'	
	Number	%	Number	%	Number	%
None	9	36	3	12	0	0
Low	16	64	2	8	4	16
Medium	-	-	10	40	17	68
High	-	-	10	40	4	16
Total	**25**	**100**	**25**	**100**	**25**	**100**

European Services Strategy Unit, 2006.

Advantages of secondment

The advantages of secondment are substantial and are summarised below:

- Employee pensions are safeguarded
- Public body retains flexibility and capacity
- More contented and secure workforce
- Improved staff recruitment and retention
- Less risk of industrial action
- Public sector corporate policies implemented
- Intellectual knowledge retained in the public sector
- Avoids fragmentation of trade union organisation

Why the PPP/PFI twin track strategy had limited impact

The trade union twin-track strategy in Britain has consisted of opposing PPP/PFI projects by national and local campaigning to expose the high financial, employment and democratic costs combined with local negotiating to secure the best possible deal for members on individual projects.

The basic thesis is that this strategy has not to achieved any significant changes in PPP/PFI policy because it failed to organise and mobilise opposition (Whitfield, forthcoming). UNISON commissioned research and publicised the findings, lobbied Ministers and MPs, organised conferences and carried national conference resolutions but it did not organise or build a national 'movement' of trade union branches, community and civil society organisations. Publicity and lobbying are insufficient to change most policies, particularly such a deep-rooted policy as PPP/PFI.

The PPP/PFI twin track strategy did achieve certain things, namely:

- National and local publicity about refinancing, cost increases and delays were widely reported which helped to maintain opposition.
- Increased political pressure on the National Audit Office and Public Accounts Committee to investigate projects.
- PFI was stopped for ICT projects – media pressure exposed cost overruns, delays and service failures but it could be argued that private ICT contractors should take most of the credit for the exclusion of ICT projects from the PFI programme.
- Publicity on high costs of PFI, in particular transaction costs, led to the £20m minimum project value being imposed.
- Recognition that in-house and DSO services could supply soft and support services in PFI projects.
- Contributed to the introduction of the Best Value Code of Practice on Workforce Matters to prevent a two-tier workforce and the government statement that value for money in PPP/PFI projects must not be obtained at the expense of terms and conditions.
- A few PFI projects were delayed and reduced in scope but others were expanded.

However, whilst these successes are important, they must be considered in the overall context of a strategy, which has failed to:

- Reduce the size, scope or depth of the programme.
- Obtain any significant amendments or changes in the PPP/PFI process. Most changes have been as a result of government policy initiatives and private sector lobbying.
- Stop the development of new PFI models such as NHS LIFT and BSF which embed the private sector within public bodies.
- Prevent refinancing and the development of a secondary market.
- Win the case for public investment, for example, only 11 health projects have been publicly funded in contrast to over 123 PFI schemes.

Opposition to SSPs has been more successful with several local authorities opting to transform services themselves, two SSP contracts have been terminated and a third substantially reduced. There are certain key differences in the structure of SSPs which make this possible:

- the alternative option of in-house provision is feasible and does not require central approval.
- PFI is mainly about access to capital investment to construct new schools and hospitals and other infrastructure projects whereas SSPs are revenue funded projects.
- SSPs have a much greater reliance on the private sector to implement ICT and business process reengineering which has been excluded from PFI projects because of multi-million pound failures. On the other hand a SSP contract is normally less than half the length of a PFI project.
- SSPs involve larger numbers, varying between 200 and 1,000, of staff.
- Finance for PFI credits and local authority capital budgets are centrally controlled in contrast to SSPs which are financed from council budgets.

Part 8

Alternative public sector investment strategies

Introduction

This chapter examines the alternatives to PPP/PFI projects. It is divided into three parts. The first part reviews the public investment options and the financing of SSP projects. The second part suggests that increased public investment must be accompanied by public policy and management changes to increase public sector capacity and control over procurement. The final sector explains why these changes must be part of a broader alternative to privatisation and marketisation of public services.

PPP/PFI is a high cost strategy

There is compelling and mounting evidence that PPP/PFI does not achieve the claimed value for money and that options appraisal and Outline Business Cases are often contrived because capital spending controls mean that PPP/PFI is the only option available.

The New Zealand Treasury has made the case that:

- There are other ways of obtaining private sector finance without having to enter into a PPP
- Most of the advantages of private sector construction and management can also be obtained from conventional procurement methods (under which the project is financed by the government, and construction and operation are contracted out separately), and

The advantages of PPPs must be weighed against the contractual complexities and rigidities they entail. These are avoided by the periodic competitive re-tendering that is possible under conventional procurement. (New Zealand Treasury, 2006)

Public investment options

Changes to fiscal policy framework: Britain and Australia have different fiscal policy frameworks and public sector net debt as a percentage of national income is close to 40% in Britain (the sustainable investment rule) but 0% in Australia. In both cases there is obvious reluctance to change fiscal rules. However, the thesis of this report is that the long-term consequences of continuing and expanding PPP/PFI are such that they warrant the re-examination and adjustment of fiscal frameworks to increase public investment.

As chapter 3 noted, the Institute for Fiscal Studies (IFS) has shown that if the A$106.7 billion (£42.7 billion) PPP/PFI deals signed by the end of 2004 had been financed by public sector investment it would have increased national net debt by 3.4% that year. The IFS Green Budget 2004 stated that “the arbitrariness of the 40% limit, and the low level of debt relative to other countries and historical standards, mean that this is unlikely to affect any fundamental assessment of the sustainability of UK government’s finances” (ibid). In other words, what is important is the political will to change fiscal frameworks. London financial institutions and financial markets are initially likely to have a negative response but should come to terms with a relatively small-scale adjustment.

Infrastructure bonds: There are wide differences between countries in the way that infrastructure is funded. Infrastructure bonds are commonly used in the US, whereas in Britain and Australia there is reluctance to hypothocate revenue to allocate specific tax revenue for specific purposes, for example, fuel taxes to fund motorways.

For example, after months of negotiations, the California legislature approved a US$37.3 billion bond package in May 2006 for which voter approval will be sought in the November election ballot. It includes four separate bond measures to fund an infrastructure programme with half allocated to transportation and the remainder for school improvements, flood control and new housing.

The case for infrastructure bonds has also been made in Queensland by John Quiggin (2004). He proposed that Queensland's fuel subsidy would be phased out over a five year period and the savings allocated to a special purpose fund. New bonds would be issued, serviced by the funds saved from the fuel subsidy. New debt would be matched to new net revenue. "At current expenditure levels and interest rates, the new revenue allocated to the infrastructure fund would be around A$100m for each of the five years, and this would be sufficient to fund interest and capital repayments on around A$1 billion in new infrastructure investment per year for a total investment programme of A$5 billion" (Quiggin, 2004).

Changes to public spending priorities: The cost of the marketisation of public services in Britain is estimated to be £8bn in one-off capital and revenue costs to date plus over £3bn annual costs (Whitfield, 2006). These costs cover subsidies, debt write-offs, capital spending and the revenue costs of 'making markets'. A large part of these resources could be available for additional capital investment and associated revenue expenditure if the marketisation strategy was reversed.

Public Public Partnerships and Shared Services projects: Local and sub-regional Public Public Partnerships were promoted by several UNISON branches and ESSU in developing alternative strategies to Strategic Service-delivery Partnerships since 2000. Shared Services projects are a similar approach being advocated by the government via the Regional Centres of Excellence.

Non-Profit Distributing Organisation model for PPP/PFI projects: The Non-Profit Distributing Organisation (NPDO) model allows reinvestment of profit in the local community and greater involvement of local stakeholders in the governance of the project company. Argyll and Bute Council in Scotland became the first local authority in Britain to establish a NPDO for a PPP schools project in 2005 (Ernst & Young, 2005). Profits generated by the project company will be given to a specially created charity instead of being distributed to shareholders. The Charity appoints a stakholder director to the NPDO board. There are six other directors, five appointed by the debt providers (Royal Bank of Scotland and Quayle Munro) and an independent director appointed by Partnerships UK. The NPDO is a classified as a private sector company for corporate income tax and accounting purposes. "Therefore, in the vast majority of respects, it is much the same as any other PPP project company" (ibid).

Whilst this model has two key advantages over the standard PPP/PFI model, it is, nevertheless, very similar to a standard PPP/PFI model. The same criticisms therefore apply.

PFI abandoned: Local authorities with a strong commitment and coherent strategies can obtain public investment. Liverpool City Council planned a A$1,070m (£428m) Building Schools for the Future project which would, had it followed the BSF model in other cities, involve a mixture of PFI for funding new schools and conventional public sector financing for the refurbishment of existing schools. The City Council had two previous PFI education projects, one included 13 new primary schools, and another involved one new and three refurbished secondary. The second PFI contract has successfully delivered a multi agency campus in Speke. "*These two projects have given the City Council invaluable experience in the delivery of large partnership projects"* (Liverpool City Council, 2005).

However, in April 2006 the city council and Partnerships for Schools (PfS) issued a joint statement that "very specific local factors have meant that in this instance PfS has decided to fund Liverpool's BSF programme with conventional capital funding" (Liverpool City Council, 2006). The BSF programme includes five new schools, six schools refurbished with work planned on a further 20 schools.

It is not within the scope of this report to examine the relative merits of different funding mechanisms for infrastructure investment. There are no easy solutions. All mechanisms have their own political and economic ramifications. However, they must be judged alongside the substantial costs and disadvantages, short and long term, of PPP/PFI projects.

Funding of SSP projects

Local authorities which rejected the SSP approach and opted for an in-house strategy have used five main sources of finance:

- revenue savings from Business Process Reengineering – the application of ICT and changes in work systems and practices frequently result in job reductions and savings which in turn fund further investment.

- leasing arrangements.
- the use of reserves to pump prime initial investment.
- prudential borrowing – good performing public bodies are allowed to increase investment based on their ability to meet loan charges.
- the authority's capital investment programme.
- various government programme and project grants.

The combined use of these resources has enabled some local authorities to restructure services in-house and procure 'best in class' ICT advice, hardware and software as and when required as part of an in-house approach as an alternative to the SSP model.

Improving public sector capacity and control of procurement

The claimed advantage of PPP/PFI projects is that the risk of construction delays and cost overruns is transferred to the private sector. But the public sector pays for this risk transfer. PPP/PFI contractors normally achieve targets and operate within budget but this is not surprising because PPP/PFI ensures much higher profit levels and construction companies also get long term facilities management contracts to repair, maintain and provide support services. They have a vested interest in meeting targets and budgets. An evaluation of European Investment Bank financed PPP projects found that projects were largely completed on-time, on-budget and to specification. "This reflected the use of fixed-price, fixed-term turnkey construction sub-contracts. These are common in PPP structures, but could also have been applied to public procurement" (EIB, 2005).

Very large complex infrastructure projects are frequently delayed and require additional funding simply because they are complex and technically difficult and neither the public or private sector can readily forecast events nor should one side always bear responsibility.

It is clear that simply increasing public investment alone is not a sustainable strategy. It must be accompanied by a series of changes in public policy, which improve project management, procurement and increase the authority's control over capital investment. These include the need to:

- Increase public sector capacity to plan, design, project manage and supervise projects.
- Introduce rigorous impact assessment in project planning, options appraisal and evaluation.
- Strengthen contract management and monitoring arrangements so greater pressure is imposed on private contractors to deliver on time and to budget.
- Strengthen public sector control of the procurement process.
- Adopt whole life costing and planning of facilities management for all projects.
- Develop integrated and coordinated delivery of in-house FM services.
- Require public sector gains from refinancing remaining PPP/PFI projects to be channelled into the finance of infrastructure projects.

Alternative to neoliberal modernisation

The debate about the future of PPP/PFI must be part of a wider discussion to develop an alternative modernisation strategy to neoliberalism. It should have a number of central themes including the restatement of public service principles and values to be embedded in all policies, programmes and projects; democratic accountability and transparency including a revitalisation and empowerment of local government; the integration of strategic policy making and service provision with the abolition of the commissioning/outsourcing agenda; the mainstreaming of equalities, social justice and sustainable development; and quality employment with a better skilled and trained workforce with good quality pensions.

Part 9
Conclusions and recommendations

The case against PPP/PFI

The case against the use of PPP/PFI other than for very large infrastructure projects can be summarised as:

The financial case

- It does not bring additional private sector investment because the cost of PPP/PFI is ultimately entirely funded by the public sector.
- Higher cost of private sector borrowing – private finance adds between 1% - 3% to the cost of borrowing.
- High transaction costs including consultants and advisers, financial arrangement fees, project management and procurement costs.
- Escalating total project costs, the difference between the Outline and Final Business Case costs is very often substantial.
- Affordability and the financial impact on budgets, which may have to be cut to accommodate PPP/PFI payments, could have a negative flow-on effect on other services.
- High cost of early termination of contracts.
- Off balance sheet finance could store up future problems and intergenerational liabilities.

The democratic case

- Erosion of democratic accountability and transparency.
- Limited stakeholder involvement because of technical complexity, 'commercial confidentiality' and reluctance of PPP/PFI consortia and consultants to engage in meaningful dialogue.
- The fallacy of long-term partnerships when contractors and financial institutions may sell equity stakes and the public sector is powerless to stop new partners taking over with different interests.

The planning case

- Misallocation of risk - transfer of risk is frequently overstated and over-priced.
- Project justified on narrow value for money criteria.
- Future improved private sector performance is compared with historic public sector performance undertaken by the same or similar companies.
- Lack of flexibility to meet changing social needs because public bodies are tied into long term contracts.
- Access to private sector expertise can be obtained more cost effectively through other procurement methods.
- Contributes to the marketisation of public services and widens the role of the private sector in the public policy making process.
- Long and costly procurement process.
- The private sector will have increasing control over the provision of the 'public' infrastructure.
- Core services will increasingly be included in the scope of PPP/PFI projects.

Recommendations

1) Planned PPP/PFI and SSP projects should be terminated.
2) Social and welfare state infrastructure must be financed by public investment.
3) Fiscal frameworks in Britain and Australia should be adjusted to increase public sector capital investment in infrastructure projects.
4) New methods of public funding of infrastructure such as infrastructure bonds should be urgently investigated.
5) The public sector must develop whole life planning and costing for all infrastructure projects.
6) The public sector should draw up an infrastructure capacity building programme to retain and extend intellectual knowledge to improve project management, technical and corporate skills and reduce reliance on external consultants. All contracts with consultants must have knowledge transfer to the public sector and capacity building clauses.
7) Public-public or shared services projects should be developed within the public sector drawing on ‘best in class’ technical advice and ICT hardware/software as and when needed.
8) Options appraisals, Outline Business Cases, contract/partnership agreements and reports and minutes of Partnership Boards should be made available for public inspection. Whilst some degree of commercial confidentiality is essential this can be protected with maximum rather than minimum disclosure.
9) An alternative modernisation strategy is essential to reclaim public service principles, re-establish democratic accountability and mainstream social justice, sustainable development and quality employment.

Appendix 1

European Services Strategy Unit and Centre for Public Services reports on PPP/PFI

Recent publications on PPP/PFI and Strategic Partnerships, many of which are available in the publications section or the Outsourcing and PPP/PFI Library at www.european-services-strategy.org.uk

PPP/PFI

- The Marketisation of Teaching, PFI Journal, No 52, April and Public Services Review: Central Government, No 12.
- Secondment of Staff for the New Tyne Tunnel PFI Project, Newcastle UNISON, 2005.
- How to Exclude Support Services from BSF and PPP/PFI Projects, A Best Practice Report for UNISON, GMB, NUT and NASUWT in Tyne and Wear using HM Treasury VfM Methodology, 2004
- Building Schools for the Future: Our Schools are Not for Sale, Council and Teacher Trade Unions in Tyne and Wear, 2004.
- Privatising Justice: The impact of the Private Finance Initiative in the Criminal Justice System, 2002.
- PPPs – Where we will be by 2001*? Review,* Public Management & Policy Association, No 16, February 2002.
- PPPs in South Australia, Centre for Labour Research, University of Adelaide, 2002 (with John Spoehr, University of Adelaide and John Quiggan, University of Canberra).
- PPP and PFI - What Future for Public Services? Centre for Public Services, 2001.
- Shedding the Light on the Newcastle/North Tyneside Street Lighting PFI Project, Newcastle UNISON, 2001.
- Lighting Up Wakefield: An Assessment of the PFI Outline Business Case for Street Lighting, Wakefield UNISON, 2001.
- Analysis of PFI Outline Business Cases in Cheshire and Cleveland.
- PFI and Europe's most privatised criminal justice system, *The PFI Report*, Issue 39, February 2000 (with Steve Nathan).
- Private Finance Initiative: The Commodification and Marketisation of Education, Education & Social Justice, No 2, Spring, 1999.
- The Employment Impact of the Private Finance Initiative, Association of Direct Labour Organisations, Manchester, 1999.

Strategic Partnerships

- The Flawed Options Appraisal and Outline Business Case for a Strategic Service-delivery Partnership, Somerset County UNISON, 2005.
- Swindon: An Alternative Route to Recovery, Swindon UNISON, 2005.
- Strategic Partnership in Crisis: An investigation of the performance of the HBS Strategic Service-Delivery Partnership with Bedfordshire County Council, 2005.
- A New Vision for Local Government in Milton Keynes and Northamptonshire, 2002.
- No Corporate Takeover of Council Services: Newcastle City Council Information Technology and Related Services, Newcastle City Council Trade Unions, 2002.
- Bedfordshire: Failing Best Value - The implications and alternatives to strategic partnership, UNISON, 2000.
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----- (2003) *The Investigator's Handbook: A guide to investigating companies, organisations, government and individuals*, February, Sheffield.

----- (2003) *Mortgaging Our Children's Future*, June, Sheffield.

----- (2004) *The Case for the 4th Option for Council Housing: and a Critique of Arms Length Management Organisations*, May, Sheffield.

----- (2004) *How to Exclude Support Services from BSF and PPP/PFI Projects, A Best Practice Report for UNISON, GMB, NUT and NASUWT in Tyne and Wear using HM Treasury VfM Methodology*, December, Sheffield.

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