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Public Private Partnerships:

Community Benefit or Crony Capitalism?

A Communist (Marxist-Leninist) perspective

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1. Introduction

In 2002 the Department of Treasury and Finance of the Government of South Australia released *Partnerships SA*. This document was a set of administrative instructions applicable to all government agencies in SA in relation to the development of infrastructure and the provision of services. In short, *Partnerships SA* encouraged private sector investment in public infrastructure where “such investment brings clear benefits to the community.”

In 2005, the *Strategic Infrastructure Plan for SA* was released, providing additional guidelines and encouragement for “new infrastructure investment by government and the private sector over a ten year planning horizon and improve the management and use of the state’s existing infrastructure assets.”

In the 2006-7 Budget, the government announced a series of projects to be known as Public Private Partnerships (PPP). These were the Education Works program for the building of six new “super schools”, the construction of new men’s and women’s prisons at Mobilong, and a new “secure care” facility for youth and a new pre-release centre at Cavan.

The completion of a PPP for new police and courts facilities in six regional locations occurred during 2006-7, and the 2007-8 Budget foreshadowed the building of the newly-announced Majorie Jackson-Nelson Hospital as a PPP in a “timely and cost effective way”.

Towards the end of 2007, Treasurer Foley indicated that a new water desalination plant might also be built as a PPP.

Our view is that the Labor state government, despite its own protestations to the contrary, is pursuing an agenda of privatization, and that insufficient public scrutiny has been directed at their preferred PPP model for infrastructure development and operation.

> “No more privatization was the catch cry of the ALP (Alternative Liberal Party) at the past State election. Now we are faced with more privately run prisons, our future water supply from a privately owned desal plant, a new hospital and hospitality services privately owned… When will they ever learn?
>
> *Bruce of Warradale, AdelaideNow website 17/12/07*

2. Putting Profits before People (PPP)

The opportunity for capitalist companies to invest in, and operate, government infrastructure (roads, bridges, prisons, schools, hospitals etc) is part of a ten to fifteen year old international phenomenon.

Whether they are dubbed PPPs, Private Finance Initiatives (eg in Britain) or 3Ps (Canada, Philippines and others) all share similar features and meet the shared needs of governments and capitalists respectively.

Dealing with governments first, it must be said that we all make a slip of the tongue at times when we talk of this or that party "getting into power" when they win an election. It would be far more accurate to say that a party "wins office" because the reality is that power resides in the ruling class of the very biggest industries and manufacturers, the very biggest banks and finance houses, the monopoly owners of the media, and those entrusted with running the army, the courts and the police. Of course, this view is not shared by everyone, but it is the view that we take as communists when we observe the myriad invisible boundaries within which even the most "radical" and "reformist" of governments operate when they "come to office". These governments have the "power" to make decisions, but whether by choice or by the simple realities of where *real* power is located, governments act as executive committees for the ruling class. They do their best for the ruling class –sometimes even settling its internal disputes and contradictions – regardless of where their electoral support is located.

The power that resides in the ruling class, including the power to shape the social agenda so that its ideas become the dominant ideas in society, is so all-pervasive that all parties contesting parliamentary office invariably feel pressure to please, or at the very least to minimize the offence that they give to, the ruling class.

To maximize their chances of remaining in office, bourgeois politicians strive for an “investment friendly” environment, for “partnerships” between government and business. And because there is a regular competition for office between parliamentary parties, there is also competition for the endorsement of the business community through the monopoly capitalist media.

Hence, the interests of governments, both state and Federal, and of whatever political complexion, are tied to the need to provide the most profitable opportunities, and most inexpensive services, to the monopolies. In this sense, the provision of PPP opportunities to private sector investors has become unavoidable for parties in office.

In relation to the private sector, it is a given of capitalist economics that the profit motive is at the heart of all economic activity. Not even the most reactionary apologist for capitalism would try to deny the primacy of the profit motive for the private sector. Private capital must seek to constantly recreate and increase its own value, but it operates in a world of finite opportunities for doing so.

Hence there is the compulsion to export capital from the most heavily industrialised (imperialist) nations to those areas abroad where labour costs are lower and raw materials cheaper. Whole industries are exported in the search for lower costs and higher profits. But even this has limits to it, and compliant governments in the major capitalist countries have looked in recent times to creating opportunities for investment in their own infrastructure projects in order to open up newer sources of profit for the big monopoly companies.

Thus, there is a community of interests between governments and capitalists that has led to the PPP phenomenon. And the question to be answered now is whether this is in the interests of the community.

In a rare moment of honesty, the *Australian* editorial commented on PPPs that “As the private sector generally expects a higher rate of return on funds than the rate at which governments can borrow, *the savings must come from either greater efficiencies in construction and management or a more direct cost to those who use the infrastructure.*” (*Australian*, Jan 23, 2008)

3. PPPs and Privatisation

Prior to the election of the Rann Government, the previous Liberal state government engaged in an orgy of privatisation. State utilities were sold off to the highest bidder despite the fact that they had been contributing to state revenue, had provided cheaper and more efficient service than what has come since, and had provided opportunities for apprenticeships and skills training. Liberal state Treasurer Rob Lucas quickly became on the nose with the community over his promotion of a privatisation agenda. Assets privatised, or opened to competition from private providers included

- the SA Gas Company (sold to Boral in 1992),
- State Transport Authority (dissolved in 1994),
- SA Water (operation, management and maintenance contracted to British company Thames Water Overseas and French company CGE Australia, for fifteen years in 1995; United Water, the company through which the contract is carried out, is now 95% owned by France's Veolia Water Australia),
- Electricity Trust of SA (Torrens Island power station leased to a Japanese company by the Bannon Labor government, ETSA broken into two and later seven entities and forced to compete on the National Electricity Market, ETSA transmission system leased to the US Edison Capital company for 25 years in 1997, the contract for the Pelican Point power station awarded to National Power, a British company, in 1999),
- Six State Government Insurance Corporation hospitals sold to private investor company Healthscope (1994), which also won the contract (1995) for a co-located private hospital on the site of the publicly owned Modbury Hospital site. The private hospital was never built, but the contract to operate Modbury Hospital went to Healthscope.

> IT'S PRIVATISATION! The government cannot hide behind fancy words such as private-public partnership. If it walks like a duck and quacks like a duck, then it's a duck.
>
> *Brian of Wynn Vale, AdelaideNow website 20/12/2007*

Given the general unpopularity of privatisation, the SA Labor government is at pains to deny any link between PPPs and privatisation. The Introduction to *Partnerships SA* reads: "The Government is strongly opposed to privatisation. Partnering arrangements are not privatisation…the Government retains a key strategic interest in the infrastructure and strong policy control over the services delivered…"

Our view is that this explanation lacks credibility. Privatisation can be as simple as the sale of a state asset to the private sector, or it can be hidden behind "competition policy" that requires former state monopolies to engage in competitive tendering on the open market, or it can be disguised as a so-called "partnership" in which governments award lucrative infrastructure contracts to the private sector for the construction and operation of public services over a set period of time. In the latter, the PPP model, even the claim that governments retain "strong policy control over the services" is open to debate: "Once the private sector controls the operational management of facilities, it is in a powerful position to influence service delivery policies" (John Spoehr, *PPPs in South Australia: Partnerships, privatisation and the public interest*, 2002).

4. Value for Money?

According to *Partnerships SA*, a "public private partnership is first and foremost a method of procurement that seeks to achieve value for money for the Government" (p. 6). And again, "The project must be able to demonstrate that, on a whole of life basis, the cost to the community of the project provided by the private sector is lower than for the equivalent project provided by the public sector" (p. 7).

The method commonly used in PPP projects to establish "value for money" is the Public Sector Comparator (PSC), an "assessment of the project's cost effectiveness if wholly delivered by the public sector, against which private sector proposals can be compared" (*Partnerships SA* p. 7-8).

Experience overseas has shown the PSC to be very much a smoke and mirrors exercise, partly hidden from public or independent parliamentary scrutiny because of “commercial confidentiality” and partly a pea and thimbles trick revolving around “discounting” and “risk transfer”.

> “What makes the difference is the cost of capital…even the least credit-worthy government could borrow money more cheaply than Australia’s most credit-worthy corporate borrower.”
>
> *Kenneth Davidson, economics writer for the Melbourne Age, 4/12/03)*

No-one seriously pretends that private borrowers can get investment finance on more favourable terms than governments. Governments (particularly when they can rest on the laurels of a AAA credit rating from Standard and Poors) can borrow much more cheaply than the private sector.

One of the attractions of a PPP arrangement to a government is that it can hide the up-front capital costs (public debt) incurred through its own financing of a project as a recurrent expenditure item made as a series of payments over the life of the PPP. According to John Spoehr, “in order to create the illusion that public sector debt levels are declining…government payments on PPPs are regarded as expenses rather than debt. As such, the payments that governments make over a twenty to thirty year period towards PPP projects are kept ‘off balance’ sheet, ensuring no addition to officially measured debt” (*PPPs in South Australia* p. 2) This is a politically attractive option for governments keen to be seen to be framing “surplus” budgets by hiding capital debt in recurrent expenditure budget lines.

The attractiveness of this budgetary smoke and mirrors doesn’t get around the fact that governments can borrow more cheaply than the private sector, and that government financing of projects is therefore better value for money for the taxpayer. Now they reach for the pea and thimbles.

The first thimble under which the pea of the real value of the project is hidden is the discounted cashflow analysis based on comparisons of interest earned on loans that are paid off quickly (government financing) or over a 20-30 year period (PPP financing). Clearly this skews the value of the project in favour of the private sector with its protracted repayment method, particularly if the discount rate is higher, rather than lower. In practice, the discount rate is usually chosen arbitrarily, and as one study of PPP hospitals in England showed, a variation downwards of only 0.5% in the 6% discount rate used in the projects turned a value advantage to the private sector into a value advantage for the public sector (*The British Medical Journal: PFI in the NHS – is there an economic case?*) It's a simple rule of thumb with accountancy: the answer can be determined by the basis on which the questions are framed.

> "Of course it is going to cost tax payers more if private investment builds the hospital. Why else would INVESTORS pay to build the hospital?? All it does is change the period the cost is borne."
>
> *Heath of Morialta, AdelaideNow website, 18/12/07*

The other thimble under which our pea can be hidden is risk transfer. When governments borrow money to finance infrastructure, they accept all the commercial and developmental risks (eg not meeting deadlines, price rises); however, if private financiers fund the project, they are meant to take on the risks. So a nominal figure, but often in the tens of millions of dollars, is added to the PSC to represent the cost of the risk that the government would have had to expend if it was financing the project itself.

There are two problems with this: one, the value of the risk transfer is quite arbitrary and can easily be inflated to make the public financing of the project appear to be poor value for money; and two, in practice the corporate world can easily evade the cost of risk and has successfully passed it back to government time and time again. This makes the exercise of adding a risk transfer component to the PSC somewhat dishonest.

The tax-paying public must have the right to know the truth about PPPs and value for money. The Public Sector Comparators for each PPP must be tabled in parliament and must be subject to independent assessment. "Commercial confidentiality" is an inappropriate defence against transparency of government interactions with the private sector in relation to the construction, maintenance and operation of public infrastructure.

> "Only the government and the developers benefit from a PPP arrangement. Past experience shows clearly that it means permanently higher costs to users and, perhaps most importantly, all embarrassing information will be hidden from the taxpayers under the cloak of 'commercial confidentiality'".
>
> *Ken of Blackwood, AdelaideNow website 17/12/07*

5. Problems, problems, problems (PPPs)

PPPs, PFIs and P3s have all run into problems interstate and overseas.

A few examples are offered here. Many more can be found on the websites listed at the end.

- The Sydney airport rail link ended up costing taxpayers $704 million when the Carr Labor government stepped in and bailed the project out.

- St Vincent's Hospital (Gold Coast) taken over by the Beattie Labor government in 2002 with losses of $10 million.

- The Melbourne CityLink tolls "are twice as high as they would have been if the tollway had been financed by government borrowing" (*Kenneth Davidson, Age, 25/9/07*)

- "The most authoritative study of Victorian PPPs, undertaken by lawyer and management consultant Peter Fitzgerald, looked at eight PPPs and concluded that they cost the Victorian taxpayer $350 million more than traditional debt financing would have cost" (*Melbourne Age*, 4/12/07)

- 1500 people demonstrated on Dec 9, 2007 in Brampton Ontario to protest the shortage of staff and beds and long wait times in emergency care at the newly opened Brampton Civic Hospital, the first P3 hospital in Ontario. "…major cost escalations across all Ontario's new P3 hospital deals have rendered unbelievable the claim that P3s come in 'on time and in budget'" (*Natalie Mehra, Director, Ontario Health Coalition Dec 10, 2007*)

- The Audit Commission for England and Wales found in 2003 that the quality of PFI schools was not as good as schools built by more traditional means; the costs of cleaning and caretaking appeared to be higher in PFI schools; PFI schools were not built more quickly.

- Audit Scotland in 2002 found that in five of six cases of new schools, the PFI *construction* costs were higher than for the Public Sector Comparator (PSC), and that in all six cases, the *operating* costs of the PFI option were higher than the PSC.
- UNISON Scotland's (public sector union) analysis of official figures from 35 schemes found that estimated public sector comparators (PSCs) were 6.4% (median) cheaper than the contractors' bids. For just these 35 schemes, that means almost £720m is being wasted - nearly enough to pay the whole of the PFI bill for Wishaw General Hospital.

6. Crony Capitalism

It is hard not to see PPP arrangements as a type of crony capitalism in which a privileged few big corporations are set up to benefit from rock solid investment opportunities with governments as guarantors. In return, these large corporations help the government to establish its "business-friendly" and "investment-friendly" credentials. This is the gist of John Spoehr's observation that "PPPs allow select private firms privileged access to market and political intelligence. They represent the hollowing out of government, drawing no distinction between public and private interests" (*PPPs in South Australia* p. 5).

Indeed, studies here and overseas confirm that the real cost of PPPs is normally higher than the cost to the government of funding infrastructure through its own borrowing. But because the government can cosy up to big business and rearrange its budget to give the appearance of running a surplus, it is happy to have the taxpayer paying more in the long run.

Federal and state Labor governments have long ago dropped any pretence that they will confront the ruling class on behalf of the people who have traditionally elected them. The Rann government now invites the corporate world to join SA Progressive Business in these terms:

The Rann Labor Government, now in its second term and with a strong majority, is seeking to build on its achievements and develop closer relationships with the business community.

South Australian Progressive Business provides a unique opportunity for business to meet with Labor leaders who are pro-business, pro-mining, and pro-growth.

Members will be able to join Mike Rann and his team at regular functions to discuss developments in policy.

Members are also invited to regular briefings by Senior members of Labor's State and Federal teams to have the chance to meet and discuss your views with other business and industry leaders who share a non-partisan commitment to maximising South Australia's economic potential.

Foundation Membership ($10,000) entitles the member to:

- Events including Breakfast Ministerial Briefings and Twilight Ministerial briefings for up to three company representatives.
- Advance notice of functions and tickets reserved for major functions for two weeks.
- Pre-event drinks with function special guest.
- Corporate recognition at functions.

Such is the party called Labor!

7. <u>The Menace of Private Equity Buyouts</u>

A further problem associated with PPPs is that the private sector fund tied up in the construction, maintenance and operation of public facilities is not protected from acquisition by other private financiers. Public equity in such facilities is not for sale in the market place (unless the government opts for privatisation). But every table in the market place of high finance is simultaneously occupied by bodies of organised finance that can be buyers one moment, and bought the next.

In the ordinary course of events, it is not unusual for one company to encourage sale of part of its assets to other companies in the hope of raising additional capital for various projects. Thus, Hochtief, a major player in PPP schools in Europe and parent company of Australian construction giants Leighton, Thiess and John Holland, announced in January 2007 a restructure to facilitate the opening up of its PPP school projects to other investors.

In this case, Hochtief did so on its own terms, and perhaps not much will change in the way that it operates its schools.

But what if the purchase of assets in a PPP investor company is "hostile"?

Nowhere is the vulnerability of private capital more dramatically displayed than in the world of private equity buyouts. Such buyouts are usually done for short term gain by owners of private capital who are happy to asset strip and sell on again at a huge profit. The assets, of course, include employees and their working conditions.

Private equity buyouts are usually leveraged, or financed largely by debt. In fact, often the company which is bought out is then forced to take out a loan to cover the cost of its own takeover!

Prisons, hospitals, schools and other government infrastructure can be impacted severely by the buyout of the majors (the PPP developers) or their contractors (eg cleaning, personnel or record-keeping companies).

Private equity has become a major growth area in the Australian economy following the Howard Government's changes to banking regulations which gave major concessions to those undertaking leveraged buyouts (LBOs). According to the Reserve Bank (*Financial Stability Review – March 2007*), over the year 2006, and following the changes made by Howard, "LBOs accounted for around a quarter (by value) of all mergers and acquisitions of Australian companies, compared with less than 5 per cent in previous years".

8. Getting further trapped in the clutches of imperialism

The largest concentrations and most aggressively expanding sections of finance capital in Australia are those that are sourced from overseas (imperialist) investors. The largest construction companies are subsidiaries of overseas monopolies. For example, Leighton Holdings, Thiess Pty Ltd and the John Holland Group are all subsidiaries of the German Hochtief Group, which has emerged as a major PPP contractor and operator in Britain and Europe. Privatisation via the PPP model leads to deeper and stronger integration into the web of international finance capital, with Australia losing control of its few remaining public assets to international finance capital and gaining only exposure to international economic crisis.

9. So what are we proposing?

It should be obvious from the above that we are not great fans of the PPP model. It is also clear that as a minor voice in the community we cannot realistically expect to turn back the decisions on already-announced PPP projects in South Australia.

However, we believe that PPP strategy favoured by Rann and Foley is bad for the people of South Australia, and that there needs to be a coalition of individuals, organisations, unions and parties that can together scrutinise what has been proposed so far, try to oppose future PPPs, and encourage governments to exercise responsibility, on behalf of the community, for public infrastructure projects.

Specifically, we call for:

- The release to the public of Public Sector Comparators for all current PPP projects in SA
- An independent assessment of the PSCs to determine the real cost to the public of the various projects

- Legal protections to be written into the PPP contracts to ensure that no cost blowouts (risk) can be transferred back to the government

- No new PPP contracts to be approved, including for the proposed desalination plant and the rumoured replacement of Yatala Prison

- A new PPP - a Public Procurements Policy – that will ensure that government accepts responsibility for publicly financing, maintaining and operating public infrastructure in the needs of the whole community.

You can assist by writing to the media or getting onto talkback radio, and by raising these issues and passing resolutions in support of them at your union or community organisation's meetings.

Further Reading:

http://evatt.org.au/publications/papers/62.html

http://www.bmj.com/cgi/content/full/319/7202/116

http://www.theage.com.au/articles/2003/12/03/1070351648877.html

http://www.onlineopinion.com.au/print.asp?article=99

http://www.ccsa.asn.au/nic/SustDev/electricity.htm

http://www.uow.edu.au/arts/sts/bmartin/dissent/documents/health/saprivatisation.html

http://www.unison.org.uk/pfi/index.asp

http://www.iufdocuments.org/www/documents/A%20Worker's%20Guide%20to%20Private%20Equity-e.pdf

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See our website at

http://www.vanguard.net.au/index.php

for regular news and analysis of Australian and international struggle.