# Bristol University Conference

# The outsourcing of governance to the market

### Position paper for discussion

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### The steady march of neo-liberalism

### Summary

This paper explores some of the unseen dangers of over reliance on PPP (Public Private Partnership) and PFI (Private Finance Initiatives). It does so with particular reference to the East Asian economies but also more generally other OECD countries. The United Kingdom is explored as an example of the hidden dangers of dependence on securitisation as an alternative to more orthodox forms of public finance

The Asian Development Bank in its 2017 Economic Outlook reminds regional policy makers that whilst growth remains buoyant in the region the rising demand for improvements in public infrastructure will in turn place greater demand on public finances. The Report focuses attention on how these needs can best be addressed through PPP and PFI schemes. In this paper we warn of the wide ranging downsides associated with over reliance on such mechanisms.

In the case the United Kingdom these matters are explored. The risks associated with the hollowing out of the state and the undermining of fundament democratic checks and balances where public finance is concerned are investigated. It concludes with the warning: beware of the threats to democracy from over reliance on these mechanisms.

### The corrosive impact of the PPP and PFI culture

The mighty neoliberal capitalist monolith - like some vast glacier - continues its slow but certain advance punctuated by continuing crises. Meaningful democratic control and accountability are gradually being pushed aside in its wake.[1] There are few aspects of civic life which are not compromised by the processes of *commoditisation*[2] and *securitisation*.[3] As the process advances everything that appears to define humanity – ethics, human empathy and respect, social and economic justice and the role of established institutions - in a longer list of pluralist democratic aspirations, is threatened. Public impotence and ultimately indifference is a consequence.[4]

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[1] Rowan Williams a former Archbishop of Canterbury writes compellingly in a recent commentary on the neo-liberal capitalist system as it staggers from one crisis to another but never recognising the underlying mechanisms that subverts its own logic. New Statesman 18th October 2016.

[2] *Commoditisation* may be defined in terms of the reduction of all economic activity to something defined by price, availability and market demand.

[3] *Securitisation* may be defined as the bringing together of those for the most part issuing debt instruments in exchange for investment funds.

[4] This is evidenced by the rise and dominance of the multimedia industry which has undermined the time-honoured debate of issues and choices based on fact and respect for independent research and verification. It promotes, in the alternative, the notion of "fake news" as a response to anything that is challenged. The election of Donald Trump to the US presidency and the British Referendum debate on remaining or leaving the EU are seen as examples of these wholly destructive developments which undermine trust and promote the ugliest forms of delusionary populism.

Britain offers some striking insights into the way these processes work following the global financial crisis in 2008 and the bailing-out of large parts of the British banking system.[5] A poorly explained snap referendum on Britain's continuing membership of the European Union (EU) is a telling example. A shallow campaign, ill understood by an electorate plied with false information produced a slim majority in favour of leaving. This in turn has set Britain on course for an ignominious and highly damaging departure from the EU. But there are other motives at work. The latest pro-Brexit slogan *Global Britain*, promotes a new glorious vision for Britain once free from the constraints of EU membership. Whilst many layered in its significance it aims to promote by stealth the notion of Britain leading the world in the adoption of new forms of outsourced public financing and public governance.[6] The attention of readers is drawn to a remarkable report entitled The UK's PPP Disaster (2017).[7]

The report sets out the major problems and risks the UK has encountered through its extensive experiment with PPPs. The conclusions of the report are summarised below:

- It has cost the government more than if it had funded the public infrastructure by borrowing money itself
- It has led to large windfall gains for the private companies involved, at public expense
- It has facilitated tax avoidance through offshore ownership
- It has led to declining service standards and staffing levels
- It has hollowed out state capacity to design, build, finance and operate infrastructure
- It has eroded democratic accountability

These aspects are explored further in the following paragraphs

**Hijacking the proper socio-economic process**

These developments cannot be assessed in isolation. The extent to which neo-liberalism has taken hold in Britain is well recognised. This has at least two significance aspects. Firstly there has been a steady drift away from the ideals and aspirations of democratic governance. These aspects have been heavily influenced by the imperatives of fiscal consolidation and austerity in the post financial crisis period. Secondly public policy is no longer defined by robust political debate but presented through a narrowly defined and tightly controlled ideological lens. Financial constraints and other cost-cutting austerity measures have been a crucial influence.[8] They have been legitimised by the bogus argument that there is no alternative.

There are few examples more telling than the contemporary Grenfell Towers disaster in London. The on-going Official Inquiry has revealed systematic abuse of proper Health and Safety Protection, Building Regulations and Fire Regulations. These abuses been driven by the growing culture of "short cutting" in order to maximise private gain and satisfy Treasury-

[5] This event entailed a massive £80bn increase in unplanned public expenditure to prevent the melt-down of the British banking system – an event that has in turn driven austerity.

[6] In this way a virtue is made of necessity by showing how capital markets and unlimited securitisation of national assets offer alternatives to well tried and tested forms of fiscally responsible public expenditure.

[7] The UK's PPPs Disaster (2017), Lessons on Private Finance for the Rest of the World. The Jubilee Debt Campaign.

[8] These matters are addressed in a papers written notably by Francesco Findeisen and John Mills published by The Smith Institute a London-based independent Think Tank "Britain for Sale" in May 2016

driven economies on spending[9]. At a local government level the quality of debate, scrutiny and accountability fails increasingly to protect citizens – a problem which affects every aspect of local government service provision, in particular local community social care and the ever cash-starved British National Health Service (NHS).

Elsewhere there are further deep-seated difficulties. The private sector of the economy reveals serious failures in corporate governance. These failures are rampant and unchecked. Lapses – often in the past portrayed as abnormal *odd bad apple* outliers - are now seen increasingly to be part of deliberate self-serving, greed - an irresponsible short-termist corporate culture.[10] Failures in corporate governance and corporate social responsibility continue to fuel social and economic inequalities. Zero-hour contracts afflict the working lives of many of the economically speaking less strong. The growth of *gig economy* has the effect of *normalising* these odious and socially divisive arrangements.

**The great hollowing-out**

Two of Britain's great historical public mediating forces, the bedrock of its democratic institutions Parliament and the Civil Service - have been progressively undermined.[11] These great public institutions have gradually been hollowed out. The vacuum has been filled by an endless promotion of the illusion of debt driven consumption shaped by the *commoditisation* of all aspects of human behaviour.[12] Capital markets have insinuated themselves into the social and economic fabric through a proliferation of mechanisms for fund raising. The scale of reliance on these mechanisms in the finance of public projects poses serious potential dangers. These dangers have mostly passed over with little serious debate. [13]

All capital market fund raising schemes results in a *securitised* claim held by some faceless investment institution. This takes the form of a claim whose payback is guaranteed by prospective tax revenues <u>and</u> prospective tax payers. This marks a fundamental change in the role of the nation state in its conduct of public finance - and its responsibilities to its citizens and communities. *Securitisation* in this example enables the state to *outsource* the funding of major capital projects at the same time avoiding an increase in national debt as traditionally defined. Increasingly projects are financed through a global capital market transaction in which those with investible funds can park their cash in whatever schemes that promise the best risk adjusted return.[14]

**The challenges and opportunities facing East Asia**

The recent report of the Asian Development Bank[15] (ADB) paints a positive picture in terms of economic prospects. Growth for developing Asia has improved, bolstered by a revival in world trade and strong underlying growth in the People's Republic of China. The region is

[9] The cadre of professional and technical officers in central and local government whose responsibilities would have been to protect standards of safety have been run down in the face of cost cutting directives.

[10] These matters are fully explored in *The Looming Corporate Calamity* by Richard Tudway, published by Heterodox Publications 2015.

[11] The countervailing influence of the British Parliament has been progressively diminished in the face of an enormous extension in the power of the executive with the independence of the civil service severely diminished. Corporate governance "culture" fails in terms of leadership on major social and economic issues.

[12] The huge increase in British household debt is a chilling reminder of similar developments in the run up to the 2008 global financial crisis.

[13] These matters are explored in depth by John Mills in The Smith Institute paper *op.cit*

[14] Growing evidence of the role played by illegal *money laundering* to fund high end property development in London is a matter of deep concern.

[15] The Asian Development Outlook, 2017 Sustaining Development Through Public Private Partnership

forecast to expand by 5.9% in 2017 and 5.8% in 2018, a slight upgrade from the ADB's earlier Outlook. Excluding the newly industrialised economies, the region is expected to grow by 6.4% in 2017 and 6.3% in 2018.

International food and fuel prices have been more stable than expected, helping to contain consumer price pressures. Inflation is expected to ease to 2.4% in 2017 and pick up somewhat to 2.9% in 2018. Risks to the outlook have become more balanced, as the advanced economies have so far avoided sharp, unexpected changes to their macroeconomic policies. Further, the fuel price rise is providing fiscal relief to oil exporters but is measured enough not to destabilise oil importers. But there are challenges ahead.

**Highlighting infrastructure needs**

The latest report warns that developing Asia must mobilize $1.7 trillion annually for at least a decade to meet pressing infrastructure needs[16]. It highlights the importance of PPP as a means of filling this gap. In doing so it stresses the importance of 'allocating risk to the party best able to manage it'. The financing gap to meet these investment needs is fast growing. Government funds currently finance 92% of the region's infrastructure investment. Some economies struggle to meet these needs, constrained by high fiscal deficits and deepening public debt. Even factoring in funds saved through public finance reform or received from multilateral agencies the needs cannot be met.

The Report highlights the fact that financing gap can be met through PPP. Bridging the gap will require improvements in infrastructure delivery. It goes on to say that PPP transforms how the public and private sectors collaborate to deliver public infrastructure and services. PPP effectively marshals the private sector's most valued strengths—incentivized finance, operational efficiency, and capacity to innovate—to meet public sector's objectives. PPP can be a conduit for infrastructure finance by institutional investors such as insurance and pensions funds.'

The dangers with these schemes have been explored earlier in this paper. Identifying the party that is best able to "manage the risk" is a short hand for saying the capital market operators are best equipped to settle priorities and the terms and conditions of funding. What is certain is that these parties have unrivalled skills in bringing together investors in projects and the parties that will offer guarantees in terms of the "required rate(s) of return". But the return to the public as the paper has illustrated too often falls far short of expectations.

These potential dangers are not passed unnoticed. The ADB reminds that Governments need to ensure a level playing field to encourage competitive private participation. 'An effective regulatory process must ensure that contracts are effective, binding, and enforceable with regard to technical, safety, and economic safeguards. Public institutions must monitor PPPs vigilantly to ensure that performance targets are met and risks are appropriately allocated to the party best suited to manage them.'

Readers are also warned that PPPs should not be pursued to procure infrastructure as an easy way of off-budget financing. Fiscal rules must be established to maintain sound and stable fiscal management. Putting together successful PPPs requires a dedicated unit able to help design effective contracts and serve as the intermediary between the government and the

[16] Over 400 million Asians live without electricity, 300 million without safe drinking water, and a staggering 1.5 billion without basic sanitation.

market. Appropriate mechanisms to provide guarantees, manage contingent liabilities, and resolve disputes as appropriate through negotiation, mediation, or arbitration can help bridge the last mile between prudent private investment and durable public benefit. Fine words but difficult to deliver on. *Caveat emptor*!

### How do we find?

Some argue that these developments reflect natural processes in the evolution of democratic capitalism. The ultimate defence is that *commoditisation* offers the best protection for consumers and their well-being as *economic utility-maximising agents*. Ensuring that governments mimic the behaviour of profit seeking corporations offers the best protection for tax payers in terms of value for money – so the argument runs. The case has an attractive but superficial plausibility. It conceals the corrosive effect of these influences on the integrity of social and political life, the standard of living of all citizens - and ultimately the meaning of sovereignty.[17]

Reducing all transactions to a profit and loss calculus must mean that there is no obvious place for public libraries, public toilets, social housing, social care and other public infrastructure needs. No room, in short, for anything that cannot generate cash on a sufficient scale to assure the pay back to the investor against the security he holds. This explains why universities appear increasingly to have no choice but to become market financed businesses. Looking to the future, hospitals, schools and other providers of social care and justice[18] will find themselves faced with similar stark realities.

### Weakening the democratic control of priorities and oversight of delivery

In reality the PPP process absolves elected governments from mediating between the different needs of different groups in society. Gradually the true *public domain* withers. If the *business model* cannot meet the needs of the investor it must leave the realm of relevant socio-economic activity. It then becomes little more than a relic of a past age. High-end shopping Malls can co-exist alongside run down urban and rural areas, the homeless and the destitute - with food banks aplenty for the needy. It is all just a matter of packaging and presentation. The media does the rest.

For these influences to be tamed democratic institutions must discover ways in which the insidious effects of *commoditisation* can be resisted. Stout assurances from the ADB won't solve the problem. There is a clear message that has to be addressed to capital market operators. If your *business model* cannot embrace the *inclusion* of objectives other than those narrowly defined by risk adjusted rates of return then the system itself will collapse. Corporate responsibility in general and investor responsibility in particular has to face and find solutions to the challenge of *inclusion*. Democratic institutions and the people that speak for them must in their turn be prepared to debate and make clear the crucial importance of these priorities. Failure to do so will threaten the existence of liberal democracy as we understand it.

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[17] During the Brexit debate there was much talk of Britain repatriating its sovereignty from the EU. The scale of dependence on *securitisation* as an alternative to orthodox public expenditure makes ultimately a nonsense of any concept of sovereignty when everything is increasingly owned by faceless global institutional investors.

[18] The concerns expressed by senior members of the judiciary over the collapse in legal aid funding in Britain and the threat to "citizen justice" these developments present is further evidence of the damage to the social fabric of trust.