

Why PPPs won't rebuild economies

Part II of an 8 September interview by economist Ellen Brown with Dr Alphecca Muttardy and Dr Stephen Hubbard of the US National Infrastructure Coalition (NIB). NIB is promoting a National Infrastructure Bank, for which a bill has been submitted in the US Congress—HR 3339. Muttardy (featured in Part I, see AAS 17 Nov.) and Hubbard are experts in the field of infrastructure finance and Public-Private Partnerships (PPPs). Hubbard is a Doctor of Public Policy with 29 years' experience in infrastructure management. (For details on why only national banking can fund a genuine economic recovery, see "[No alternative to a National Infrastructure Bank](#)", Washington Insider, AAS, 14 July.) The [full interview](#) is available at Brown's "It's our money" podcast.

Brown: Dr Hubbard, I wonder if you could run us through PPPs, and why it's really *not* the way we want to go?

Stephen Hubbard: First, I'm not sure the listeners will know what a PPP is, and the definition is actually variable. So let me start there, and then I can go through why they work in some cases, but only a very small percentage.

So first off, project creation for infrastructure, whether it's "hard"—roads, bridges, buildings—or "soft", as it's now being called, like day-care, childcare, healthcare, things like that, is basically the same. And it starts with the *design* process, which also includes planning, which is basically "What am I going to build? Why do I want to build it? And where am I going to build it?" And then, *financing*, used here in the general sense—whether it's grants or loans, whether I have to pay the money back or not. Then *build*; and then *operation* and *maintenance*. And so it's known usually by the initials DBFOM, though you can see other combinations because everyone's got their own particular mix.

So, traditionally, government does what's known as "design-bid-build", and they hire a contractor for each of the steps of the DBFOM process. This is so if I'm a designer, I can't write a specification that only I or one of my cohorts can then apply for. Because when you don't have that requirement, as you can imagine with billions at stake, there's a lot of corruption, and people write things that only they can then bid on. But as you can also imagine, this creates a time-consuming process. Inflation in construction actually runs higher than standard consumer inflation; the *Engineering News* has a "heavy construction" and a "building construction" inflation index, and it usually runs a per cent or two higher than standard consumer inflation. It tends to run at between 40 and over 100 per cent per decade, depending on what it is you're trying to do, for what are known as "mega" projects, very large projects over \$1 billion. [All figures in US dollars] So basically, if I'm an agency and I'm trying to build something, I can run into problems, such as I don't have the expertise or the capacity to do the project: I don't have the staff hours, or I don't have that knowledge in-house; and I also don't have either the money or the political capital to get it built. And many times, as an agency, you know something needs to be done, but you can't get the political willpower to have it executed.



Dr Stephen Hubbard. Photo: NIB Coalition

A Public-Private Partnership is basically where two or more of those stages—design, build, finance, operate and maintain—are done by the same contractor, or group of contractors if it's an organisation. They also may contribute private equity; and this is where the true PPP definition differs from a lot of the loose ones, in that basically the contractors assume both the risk of creating the project—because they've got more than one step—and they are also putting in cash up front. And this is why Congress is now interested in PPPs, and why there's a PPP component in the current infrastructure legislation. They're hoping to get money.

PPPs: finance, not funding

And so here, just in terms of definitions, *funding* means grants; for example, normally, if you're, say, a road agency, you get so much money per year from the US Department of Transportation (DOT), that's a grant. Whereas they have many different *financing* programs, where you get some money upfront, you have to put more in yourself, and then you have to repay the loan. So here, this is traditional *financing*, which means loans that have to be repaid. So, to be very clear: PPPs are not funding, they are financing; in other words, the private enterprise has to make money. Because if a corporation doesn't make money, they go out of business.

So what's the advantage? Why do this? For many agencies, and for the federal government, there are debt limits, or debt-to-revenue ratio limits—and PPPs are "off the book". You owe them some money, which you'll pay, so basically you incur a debt; but they're putting in equity, which you'll pay back

over time. That doesn't count towards your classical definitions of "debt", so it's a way of getting money without putting it into the debt/revenue equation.

As Alphecca showed, the US infrastructure deficit— at least, the one that people talk about, from the ASCE— was \$1.9 trillion, then \$2.1 trillion, and now it's \$2.6 trillion. That's every four years, it's been jumping. But it's really much larger than that. As you might remember her saying, they have 16 categories; but it turns out there are many more that aren't included, including things like groundwater depletion—50 per cent of US food right now comes from farms irrigated by aquifers that are depleting under drought stress, and putting the water back will cost 10-20 times what it cost to pump it out. Imagine what that will do to your food bill! And when you put that into the deferred maintenance costs, you wind up with somewhere between \$4 trillion and \$7.5 trillion, and some people in Congress believe the number may even be above \$10 trillion. That's just to fix what's broken, after 40 to 60 years of austerity.

On top of that, now, as Alphecca also mentioned, we have the "pay as you go" rule (PAYGO), which means you can't add anything to the federal deficit without first finding either a tax, or a spending cut. It's like running a business where you can't borrow money to try to increase your revenue. And then there's also a financial sector cheering squad who are saying "We can save you! We can save you! Come let us lend you money and we'll make everything better!" And there are trillions of dollars of corporate profits stashed offshore, and they're looking for longterm contracts with governments which basically can turn into government-enforced monopolies for 15-30 years or more. And of course, every business would love to have that sort of situation. But you have to remember, PPPs are not free money. You have to pay it back. And the public is ultimately responsible for that debt.

One of the issues when you start doing PPPs is that the general return on equity for the investors is somewhere between 10 and 15 per cent. That comes from the fact that in terms of international finance, I can go find opportunities that provide at least 10-15 per cent return on investment per year. So as the money sort of sloshes around from best investment to best investment, obviously the highest returns for lowest risks go first; but you still have to get up into that neighbourhood of 10-15 per cent return on investment, otherwise you're not going to attract the capital. In other words, if I have \$1 to invest, why should I put in something that'll get me only a penny of two back per year, when I can go offshore and find 10-15 cents? And the answer is, no-one will do that.

Another problem with PPPs is it's an adversarial relationship. When the government puts a project together, it's basically trying to maximise the public benefit per dollar. What a PPP is trying to do, it's trying to maximise the profit for its investors. If there are any savings, they go to the investor; and if there's a failure then the government is always the ultimate person who's on the hook. They're the ones who are responsible if the PPP fails. And as an example of the kinds of things that can go wrong in a PPP, where you're basically farming out everything to an organisation: if you give them a specification, and there are mistakes in there that will make them money, then you will never hear about it. Part of that problem is 700-page contracts which are impenetrable. And part of the crowd that put the "Third World" in debt, and has kept it there for decades, is now looking for something new to do, and they're now looking at US infrastructure as a way to increase their profits, and so they're looking to take all that cash they have offshore, and use their complex econometrics procedures to try and get agencies into long-term projects. And the longer the contract—say you're going to privatise your water system for 30 or 40 years—the higher the risk.

Not all PPPs are bad. There have been successes. Historically, the Erie Canal was brought in under budget, and early; and of course, also, the Transcontinental Railroad was one of the first major PPPs in the United States. Things like concessions on insect control, and trash removal—many cities contract that with Waste Management Inc. or some of the other big organisations in that field. And the reason why those work is because the employees only take a few years to train, and if you change employees you don't lose 30 years' worth of knowledge that's going out the door. Whereas if you have a water system, and you have poor hiring standards, you keep losing the knowledge of how to run the agency more efficiently; or when you take it back over, they all leave.

So this is why there are hidden costs in PPPs. The Congressional Budget Office (CBO) has evaluated them and said that basically the cost of money from private equity, versus the government with its inherent inefficiencies—because they're trying to prevent corruption—is nearly identical. But that said, and especially for rural areas, there's not a lot of capacity for extra PPP debt. In terms of water systems, there 52,000 water systems across the United States, but only 880, about 1.7 per cent, have been privatised, indicating again that PPPs are only good for about 1-2 per cent of all infrastructure. Another example is roads: there was a Brookings Institution study that showed that 61 per cent of all roads break even or lose money. Where are you going to get 10-15 per cent return out of that? You can't. But what some agencies do is they have a new bridge, or a new tunnel, and they say "OK, well, we'll run a toll on that, and we'll have a PPP build it and operate it for 30 years." But what you've done, without realising it, is you could have basically done that project too, for a little bit more up front, and then had the revenue from that to help fund parts of your system that are not making money. And so when you privatise it, and farm those profits out for 30 years, now you have to go raise taxes elsewhere. So even though the PPP itself may show that it was beneficial, there could actually be a net loss.

Spectacular PPP fails

There's I-69 (**Interstate Highway 69**) toll road in Indiana, which was a greatly ballyhooed PPP, they



The Interstate Highway 69 toll road in Indiana was supposed to save the government a lot of money, but the private contractor went bankrupt and the government had to take over the project at enormous cost. Photo: YouTube

were going to save an enormous amount of money for a long-term maintenance contract. But what happened was that the traffic projections were inflated for them to get the project, and so they went bankrupt and the government had to take over, at a cost of \$350 million up to about \$550 million, with the project two years behind schedule. So what looked like a very good thing at the start, and was ballyhooed across all of the infrastructure press and the financial industry, turned into a turkey.

There's the **South Bay Expressway** in San Diego, California—the SR-125—that went bankrupt, again because of low traffic on the toll road, and ended with many lawsuits. And they actually had to cancel the improvement works for I-805, which, if you know anything about the San Diego area, always has tremendous traffic delays, to pay for the loss on the toll road.

The **London Underground**, in 1998, contracted with three different PPP groups to re-build the subway, which had been run under austerity for quite a while. Those all went bankrupt, at a cost to the city of somewhere between \$175 million and \$500 million. And just as a rule of thumb, when I talked to one of the consultants who was trying to clean up after the PPPs, he said that the London Underground had figured, looking at the amount of deferred maintenance, that it would take them seven years of normal operation to clean up the mess for every year of austerity that the organisation had been run under. So that gives you an idea of how badly under-spending affects an agency.

And then in general, **private water systems**. Food & Water Watch has looked at water systems that are privatised, and their costs go up an average of 33 per cent; and sewerage systems, the costs go up 66 per cent.

And then we have the four biggest PPP failures, at least in the United States, starting with **Three Mile Island**. Basically, a company was hired to run the Three Mile Island nuclear facility in Pennsylvania, and was running it to take advantage of a small tax incentive while it should have been shut down—they had to keep it up for a certain number of hours to get that small tax advantage. And of course in March 1979 the thing partially melted down—about 50 per cent of the core—because they had a problem, and they ran away. And that cost between one and two billion dollars.



The Deepwater Horizon oil well in the Gulf of Mexico, constructed by a Public-Private Partnership, blew out because the proper checks on construction were scrimped on. Photo: YouTube

In California, there was the power crisis in 2001-02. In **California power** electricity was deregulated—this was a form of PPP and privatisation, and the idea was they were going to use the “power of the marketplace” to reduce costs. Instead the cost of power went up by a factor of three, because we

didn't have the grid—that's one of the things that the NIB Bill will pay for, is a better grid. And at the **Metropolitan Water Districts**, our cost of for power went up \$130 million in one year, because of Enron manipulating the market. It actually put the USA into a recession! Remember when President George W. Bush took over, he said the economy looked worse than they had originally thought? That was because the manufactured power crisis in California had brought about a mild recession across the country.

Next is the **Deepwater Horizon**, which was a \$3 billion oil well in the Gulf of Mexico. To save \$100,000, a test that would have checked if the well was properly cemented closed or not was skipped. And of course, the well blew out; and the cost of clean-up is now above \$61 billion.

And currently, the ultimate privatisation fiasco just occurred this year. Texas in 1970 took over its power grid and sort of gave it to an agency, and essentially disconnected it from the rest of the US grid. After that, **Texas power** prices rose 60 per cent faster than across the United States; since 2004, Texans have paid \$28 billion more for their power than everyone else. There was a freeze in 2011, which prompted many reports warning ERCOT (the Electric Reliability Council of Texas), the Texas power operator, that they could suffer catastrophic failure if there were another cold snap. But they didn't bother to require any of the power companies to spend the money to "weatherise"; and so of course on 10 February there was a cold snap, and for two weeks most of Texas—4.5 million homes—was without water or power, at a cost of \$200 billion-\$300 billion dollars and between 200 and 700 deaths.

And what happens over and over again where there are these large failures, from individual roads to major systems, is that the PPP crowd says "That's just an aberration! Overall, it does well." And it does do well in a very limited area. But once you take PPPs and expand them out into systems, and make long-term contracts, the results are mixed, at best; and as you can see, very large fiascos can occur that costs enormous amounts of money, and can actually kill people.

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