AUSTRALIAN ALMANAC
Vol. 11 No. 31

Failed PPPs a hallmark of collapsing neoliberal system

One of the underpinnings of the neoliberal ideology—adopted by both Liberal and Labor in what Prime Minister Julia Gillard in 2011 described as the "post-1983 consensus on economic reform"—is the notion that only the private sector makes economic wealth.

In an 8 November 2013 speech to the Centre for Independent Studies (CIS), then-Treasurer Joe Hockey declared that "wealth and prosperity are created by the private sector" and the role of governments is to "become a facilitator for private-sector growth". In August 2012 he told the Sydney Institute that government programs and entitlements should be slashed, "because it leaves more resources for the private sector to reap the rewards".

The Public-Private Partnership (PPP) model is a key part of this philosophy. The Global Infrastructure Hub launched by Hockey in 2014 at the Brisbane-hosted G20 summit, in parallel with the push for G20-wide bail-in laws, was a key vehicle to promote PPPs globally. The Sydney-based operation, with a former Macquarie Bank director at the helm, was designed to match private investors with infrastructure projects. Macquarie pioneered modern PPPs, which "incentivise" private investors with high profits guaranteed by the public purse, promoting them as the preferred model for infrastructure financing the world over. ("G20 financial engineers aim to commoditise infrastructure", *AAS,* 15 August 2018.)

When US President Donald Trump was elected after campaigning for a US$1 trillion infrastructure build, the Turnbull government led a charm offensive to push him into using the PPP model. ("Australian mega-delegation to woo Trump on geopolitics, PPPs", *AAS,* 21 February 2018; "Australia's PPPs will sabotage a US economic recovery", *AAS,* 28 February 2018.)

The historic origins of PPPs began in Benito Mussolini's Italy (1922-45). All the country's national highways were built using the PPP approach, and as with modern examples in the USA (immediately below), private firms were frequently bailed out when they failed ("Mussolini program was model for today's PPPs", below). Mussolini's doctrine of fascism was essentially a "merger of state and corporate power", as described by Giovanni Gentile, a Mussolini minister and self-styled "philosopher of fascism". Amid a "concentration of private power without equal in history", also developing around the efforts of Wall Street interests in parallel with the powerful financial factions backing Mussolini and later Hitler, US President Franklin Roosevelt in a 1938 Message to the US Congress on Curbing Monopolies attacked fascism as "ownership of Government by an individual, by a group, or by any other controlling private power".

In 2003 Macquarie Bank executive Dennis Eager boasted to prospective investors that toll roads were a licence to print money, saying: "We can put up the tolls by whatever we like and, almost as importantly, we can start the tolls on day one by whatever we like…. If [motorists] don't complain about it being too high, then we won't have done our job." Photos: Wikipedia; Travellers Autobarn

Infrastructure investment under this PPP model is a driver for private profit, not real economic growth that universally benefits all. In fact, as the examples below show, it usually ends up profiting a select handful at the public's expense. The PPP approach has left Australia with an infrastructure deficit conservatively estimated at more than $600 billion—for Australia to achieve the infrastructure development that is desperately needed to recover from the current economic crisis, governments must dump the PPP model and return to honest public investment instead, preferably through a national infrastructure bank.

Macquarie Bank exposed as a giant Ponzi scheme

By Paul Gallagher. This is an edited version of an article first published by Executive Intelligence Review *magazine on 9 May 2008.*

Governor of Pennsylvania (2003-11) Ed Rendell's drive to "privatise"—sell off—the Pennsylvania Turnpike, supposedly to build or maintain other state transportation infrastructure with the proceeds, is a product of desperation, as he admits, at the 40-year lack of a Federal capital budget for infrastructure. The governor put out a final call for bids on 15 April, trying to accelerate the privatisation and get the legislature to approve it by 10 June. The top bidders to grab the turnpike's tolls are led by the Macquarie Bank/Cintra Group combine that has already taken both the Indiana Toll Road (see case study below) and Chicago Skyway private; and as with those deals, Pennsylvania drivers would pay a 25 per cent toll hike starting next year. The deal has brought Rendell into a closer alliance with the Mussolini-corporatist "soulmates", fascist banker Felix Rohatyn, New York Mayor Mike Bloomberg, and California Gov. Arnie Schwarzenegger, in their Rebuild America's Future Coalition for public-private partnership (PPP) swindles.

Macquarie Bank itself, which is the world model and leader in such infrastructure privatisations, is being exposed in new financial analysis reports, as running nothing more than a worldwide group of "public-private Ponzi schemes", funds whose 25 per cent-a-year "profits" depend on looting new investors, overvaluing ventures, and dramatically jacking up tolls and other user fees on the public infrastructure they grab. So obvious is the Macquarie swindling, that one can foresee signs at the Pennsylvania toll booths, "You must each sell toll cards to ten of your friends, to keep the turnpike going."

Macquarie has begun to be referred to as "the Bear Stearns of Australia", where it is headquartered, with the markets and the press anticipating that the Macquarie house of PPP cards is about to come down. The share values of its infrastructure funds have lost about one-third in 2008, and stocks of the bank itself, 42 per cent.

More accurately, an early-March mass leaflet of the Citizens Electoral Council [now Australian Citizens Party] called

Macquarie "the Enron of Australia"—a weapon of the British financial oligarchy deployed to shatter and loot the means of public infrastructure investment and regulation in many countries, and then to be allowed to collapse when that wrecking job is done. Macquarie Bank is a 35-year outgrowth of the London imperial crown bank Hill and Samuel Co.

The London *Economist* jumped to Macquarie Bank's defence in its 17 April issue, admitting that "If Macquarie fails, many people will say that it should never have existed", and that it "persists only with a rising value of the [infrastructure] assets"—which any economist knows must be depreciating in real economic terms—but insisting that Macquarie has created a "new model of locking in investors and extracting value from assets"—i.e., looting.

Report is a 'haymaker punch'

Under the heading, "Macquarie Model Blowtorched", the *Sydney Morning Herald* on 4 April reported that a leading financial think-tank, RiskMetrics, Inc., had exposed the Macquarie PPP method "for infrastructure" as a combination of Ponzi schemes and looting binges against investors, taxpayers, and the public.

In 15 years, Macquarie has set up dozens of "investor infrastructure funds", which have privatised a hundred airports, bridges, tunnels, and turnpikes worldwide. Macquarie manages these funds with tight control and extraordinary fees; leverages them with debt (often borrowed from Macquarie Bank) at a ratio of anywhere from 2:1 to 5:1; and pays a "return" which has averaged 20 per cent a year since 1996. This return, as the *Economist* had to agree with RiskMetrics' report, is completely unbelievable for investments in the staid toll collections of a bridge, tunnel, or turnpike, or the user fees of an airport.

Macquarie Bank's PPPs—together with other funds of its "group" such as the Spanish Cintra Group and the Brown and Babcock group—are the model pushed by Felix Rohatyn and other fascist bankers whenever "infrastructure" is raised, especially in US Democratic Party circles. What the *SMH* called this "haymaker" exposé by RiskMetrics, gives that model a stink which will spread from the Chicago Skyway to the Loudoun County, Virginia "Greenway", the robber baron private toll road constructed in the 1980s and now owned by Macquarie.

"The RiskMetrics research, the most thorough yet done on the model", continued the *SMH*, "is likely to send shockwaves through the sector, and give both state and federal governments cause for concern, as governments have mostly privatised public assets through this [MacquarieGroup PPP] model."

RiskMetrics says, "The infrastructure model raises investment-related concerns: overpaying for [infrastructure] assets; widely overestimating toll and other revenue flows; high debt levels, high fees, paying distributions out of capital rather than cash-flow ... booking profits from mere revaluations", etc.

PPP = Pick-Pocket Ponzi

Here are leading examples of the RiskMetrics findings on the Ponzi-scheme character of the Macquarie PPPs:

• Most of the Macquarie and Brown-Babcock infrastructure funds are incorporated in Bermuda, because under its law, funds are allowed to pay out annual returns to investors, and performance fees, without making any profit, or even while losing money—something not allowed by Australian, or even City of London regulations;

• The yield to investors for many of the funds was sourced both from cash flow and from new capital invested—the classic marker of a Ponzi scheme;

• Macquarie Infrastructure Group (MIG), the "model" PPP fund structure, in 2006, had only $306.9 million in operating cash flow, but paid out $512.9 million in stock distributions, and additional hundreds of millions in fees and executive salaries that year. The "profit" distributions alone were 116 per cent of the total toll revenue for the year, driving the toll structure up;

• A smaller PPP in the group, Babcock and Brown Wind Partners, managed to distribute $48 million in fees, bonuses, and new stock during 2006, while having an operating cash flow of only $14.2 million;

• MIG in 2006 paid out "profits" from: 1) two securitisations of expected future cash flows; 2) a $600 million debt refinancing; and 3) $767 million in new investment capital raised!

• The Macquarie fund managers base their management fees, and performance fees, on percentages of the "enterprise value" of the assets of the fund, and they include in this enterprise value, the bank-debt borrowed by the fund, which may be two or three times the invested capital. A Macquarie document states, "The sustainable and growing long-term cash flows of infrastructure assets mean that [they] can typically support more debt than other businesses, which can increase returns. This indicates the importance of financial structuring and capital optimisation in enhancing shareholder returns."

• For 18 Macquarie funds analysed, management fees for 2006 alone ranged from 10 per cent to 313 per cent of total annual cash flow, and in one other fund which lost money, were 20,060 per cent of cash flow;

• Macquarie systematically overvalues the infrastructure assets its funds buy, then periodically upvalues them further according to its own computer models. This results in "gains" to shareholders, and demands increases in tolls and other user fees;

• The fund entities have multiple boards, all of whose members get stock distributions and bonuses;

In an escalation of this Ponzi swindling, Macquarie on 15 April touted a new device, "listed protected lending", to potential new investors. Directly echoing the infamous "interest-only mortgage" of the subprime meltdown, this scheme lets investors "buy" new Macquarie fund shares entirely with loans at 12 per cent or more, and collect the share "profit" distributions, without legally coming to own the shares unless they pay off their loan at the end of a year. This refinement was invented to raise new "investors" in Macquarie funds intended to go, for the first time, into privatising infrastructure in China and India.

The most smelly example of what the fascist "soul brothers" Felix, Mike, and Arnie are trying to pull governors like Rendell into, is the Dulles Greenway in Northern Virginia, "America's first private toll road", and Macquarie-owned. It has tripled its tolls in less than two decades and in spite of two state bailouts, and is about to raise them again, to the point that drivers will be paying $5 to travel a 16-mile extension, of a public toll road of twice that length which costs $1.25 in tolls.

But recently, private financial interests have claimed that if they can buy the public toll road (raising tolls and slapping on new "congestion tolling"), they will extend Washington, DC's metro rail service along its line, to the Dulles International Airport.

The Pennsylvania legislature's Democrats have produced a report, "For Whom the Road Tolls: Corporate Asset or Public Good", which shows that selling the turnpike to Macquarie is the most costly, least effective way to use its toll revenue for infrastructure, and that the state, over the span of 50 years, would be forfeiting to Macquarie 45 per cent of the revenue of the current tolls, even before Macquarie sets about raising them for its own Ponzi profits.

Build a maglev, don't sell a road

But Pennsylvania has had a plan for new magnetic levitation (maglev) and high-speed rail (HSR) corridors across the state, which would be part of a new rail corridor from New York State to Illinois and Missouri. Governor Rendell said at a Washington, DC conference on 30 April, "We have no high speed rail. We should not be flying to cities that are less than 500 miles apart. I would love to build a high-speed rail from Philadelphia to Pittsburgh."

High-speed rail (200 km/h) and maglev (350 km/h and more for passenger travel) corridors are not only the sane alternative to Ponzi schemes to gin up "private investment" by increasing toll looting on congested roads. They are also the means of "bringing the good jobs back" to formerly industrialised areas across this entire region, because they demand the steel, the electrical power, and the industrial and construction skills which are at the centre of debate in the Presidential primaries in those states.

In 2006, *EIR*'s economics staff "animated" the impact on the 1,000-mile-plus stretch from New York and Philadelphia to Chicago, of the development of high-speed rail corridors already planned by those states, individually and in rail-plan coalitions. The impact on the economy of making the thousands of tons of steel per rail-mile, and all of the machinery, control equipment, power and transmission capacity, etc. which high-speed rail demands, was stunning. As would be the impact, in productive jobs, on the hundreds of counties in the envelopes of these high-speed rail corridors.

CASE STUDY: PPP/Macquarie Bank roadblock hits Indiana

Republished from AAS *19 July 2017*

The latest example of PPPs' (public-private partnerships') failure to deliver infrastructure is evident in the US state of Indiana, where on 16 June state authorities officially announced that Indiana will take over control of construction on the 21-mile (34 km) extension of Interstate 69 from Bloomington to Martinsville, away from the PPP private partner, I-69 Development Partners. The stretch was to have been completed by October 2016, but has been delayed four times since construction started and is only about 60 per cent finished. The prolonged construction has increased traffic accidents and lengthened commute times. The state now expects to complete the highway by August 2018.

The story of I-69 Development Partners and its parent company Isolux Corsán, a Spanish-based multinational, was a farce from the start. Its group bid of $325 million—about $73 million less than the closest competing bid—was $22 million less than Indiana State's own cost estimate. A mere three weeks after the contract was finalised, nine company and public officials in Spain were arrested on embezzlement charges. They have allegedly profited illegally from a bribery scheme related to a high-speed rail project built by Isolux, a scandal that's still unfolding in Spain.

This is not the first time Indiana has been stung with privatised infrastructure funding. In 2006, budget-cutting fanatic Gov. Mitch Daniels proposed that Indiana could amazingly avoid making capital investment, not have to raise taxes, and get a share of the tolls, if it privatised the Indiana Toll Road (ITR) that traverses 156 miles (252 km) across the State's north connecting Illinois to Ohio. The State leased the ITR for US$3.8 billion for 75 years, to a PPP consortium comprising two companies: Australia's Macquarie Group, and the Spanish company Ferrovial. The two formed a special vehicle company called the ITR Concession Company (ITRCC) to run the toll road. At the time this was America's biggest infrastructure privatisation.

Opened in 1956, the ITR was publicly financed and constructed to serve the public good, but after just a few years of ITRCC management, on 21 September 2014, the company filed for bankruptcy, despite sharing in toll revenues for eight years. Macquarie, the senior partner, ran the looting, borrowed to pay dividends, and carried out other corrupt practices that are not remotely connected to running a highway. Yet, Macquarie made money, even as the Indiana Toll Road was hurtling to bankruptcy.

How? This highly speculative game worked via three phases: a highly leveraged purchase; securitisation; and a torrent of fees.


Construction of the I-69 tollway in Indiana. Photo: YouTube

Leveraged purchase: Macquarie and Ferrovial put up less than US$400 million of their own money of the US$3.8 billion required for the lease arrangement: the remaining 85 per cent—US$3.4 billion—they borrowed from seven European banks (six of which have since been bailed out by their respective governments). Macquarie borrowed much of its money in the form of a derivative, called an accreting swap, which is structured with a low initial principal payment that later mushrooms sharply. Logically Macquarie defaulted on payment on both interest and principal.

Securitisation: Macquarie split its US$1.9 billion share of the Indiana Toll Road ownership into two funds: Macquarie Infrastructure Partners, for large investors, and the Macquarie Atlas Roads company, for pension funds and banks. (The Macquarie Atlas Roads fund also owned parts of the Dulles Greenway, the Chicago Skyway, and the South Bay Expressway, all of which went bankrupt.) Macquarie was securitising highways and other infrastructure, the same way that Wall Street securitised home mortgages. It sold shares on which it paid dividends from the few infrastructure projects it owned that produced positive revenue; according to one source, it also incurred new debt in order to pay dividends. The latter process is a Ponzi scheme. Still, Calpers, the largest public pension fund in America, and others, invested in Macquarie infrastructure funds.

Torrent of fees: Yet even as the physical and financial side of the investment was going to seed, Macquarie made money through fees. The shareholders who bought shares in the Macquarie toll road funds paid Macquarie management fees, which can run from 7 to 20 per cent of the value of the fund. The larger the fund, the larger the fees paid. In fact, to everyone's surprise, in 2006 Macquarie and its partner outbid their nearest competitor by $1 billion for the Indiana Toll Road. It seems crazy. But the bigger the fund, the more the fees. As an investment bank, Macquarie also earned money from transaction fees, which its infrastructure fund paid every time its banking arm rearranged investments into new corporate structures or refinanced a loan. Additionally, Macquarie also paid itself handsome annual fees to manage its numerous satellite entities. One analyst called Macquarie a fee factory.

The results of ITR's privatisation were: An unpayable US$5.8 billion in debt; infrastructure deteriorated; and tolls escalated. The toll on the ITR rose from approximately US$4 when it was leased in 2006, to US$12.64 today. In 2015 Australia's IFM Investors acquired the ITR for US$5.72 billion ($7.5 billion) and naturally, the looting continues.

The Congressional Budget Office reported that between the mid-1980s and 2006, some 30-40 per cent of new highways were built through PPP vehicles; now, Streetsblog USA reports, that this is almost 70 per cent.

Macquarie Group's looting may fast be coming to an end. Now the world's largest infrastructure manager, reports are emerging that Macquarie could be forced into a fire sale of assets as it comes under pressure from rising interest rates, big debts and stalled earnings. As reported in *The Australian* on 11 July, Citi analyst Craig Williams said Macquarie is now "potentially facing the same challenges that the industry faced in 2008" before the global financial crisis. Williams said "a number of factors such as high asset valuations, the low likelihood of large future performance fees, and a rush away from active asset management towards passive funds meant Macquarie's bull run was probably over."

The lessons here, and the world over, should be clear: Public credit through national banking is the only way to finance infrastructure for the common good.

Mussolini program was model for today's PPPs

By Claudio Celani. Republished from EIR *4 February 2008*

In 1922, as soon as he was installed as Italy's Fascist Prime Minister, Benito Mussolini adopted a scheme drafted by a group of Milanese industrialists for a concession to build the first Italian (and, it seems, European) highway, the Milano-Laghi, to connect the industrial cities of Milan, Varese, and Como. The concession was to last 50 years, after which the highway would be given to the state. The concession included the status of public interest for the work, so that land expropriations could be quickly (and, presumably, cheaply) made; it included a fund guaranteed by the state of up to one-third of the total cost, which the private investors were able to use in case they ran out of money; and, of course, a toll system to repay investment costs.

That scheme was to be applied to the construction of all highways under Mussolini, for a total of 479 km, which would be operative between 1924 and 1935, with some variations; for instance, for the 23 km-long Naples-Pompei highway (1925-29), private investors spent double per kilometre as on the other highways, and received a fixed rate of interest from the state. The Venetians, for the Padova-Mestre highway, got one-third financing from local governments, and two-thirds from an agency formed by the same local governments and the state. For the Milano-Bergamo highway, the state put in two-thirds of the money.

The Fascist PPP (public-private partnership) model under Mussolini was based on the same hoax promoted today by Schwarzenegger-Bloomberg: The economy needs public infrastructure, but the state has no money. The private sector has the money, and investors are willing to take the risks to build such public infrastructure. Contrary to what President Franklin Roosevelt did with his massive public works projects, like the Tennessee Valley Authority, during the last Great Depression, Mussolini's program was not part of a general infrastructure-building and economic recovery plan, and could not be so, because the only thing that private investors were looking for, was to make a profit. Eventually, projections of highway traffic were revealed to be over-optimistic, so that profits failed to hit the mark. At that point, the state came in and bought back the infrastructure.

'Going ahead without money'

For example, the Milano-Laghi: The project was based on a projection of 1,000 automobiles travelling per day; as of 30 September 1925, the number was 800 cars. In 1926, the annual traffic was 421,406 vehicles—still low. Consider that, in 1922, Italy had one car per 1,000 inhabitants, compared with the USA, with 100 cars per 1,000 inhabitants. Under Mussolini, mass motorisation never occurred. So, one by one, the PPP infrastructure projects were bought back by the state, as profits failed to meet demands of private owners. When, in 1933, the Milano-Laghi was taken over by the state, the condition of the highway was disastrous, due to the lack of investment in maintenance.

Benito Mussolini. Photo: Wikipedia

Starting in 1929, the investment policy was inverted: After the crash of the free-market economy, the private interests had no money, and the state had to bail them out. Mussolini then became a statist, in favour of "big government". As concerned roads, the government established a national corporation, the Azienda Autonoma Strade Statali, whose task was to maintain existing roads and build new ones. The AASS was a failure, because the Fascist government was unable to generate credit. In fact, from 1923 to 1938, with the exception of the new highways, the Italian national road network shrank, from 20,622 to 20,324 km; provincial roads remained unchanged (42,578 km), and only communal roads rose from 106,800 to 110,280 km. Even the national roads, which were more modern, were not paved.

AASS was such a failure, that Italians called it Andiamo Avanti Senza Soldi (Going Ahead Without Money).

Ironically, from a technical standpoint, the first generation of Italian highways were well constructed, reflecting the high skill level of Italian engineering and of American machines! To pave with the Milano-Laghi with cement, engineer Piero Puricelli bought five large Koehring-Paving machines in the United States, able to produce 1,200 square meters of conglomerate per day. Also, due to the orography of the Italian territory, many bridges, viaducts, etc. had to be built. Had the highway program been part of an FDR-like general recovery plan, financed with public credit, it would have been successful. As a profit-maker, it was doomed to fail from the start.