

The Mersey Gateway Public Inquiry 2009

SUMMARY OF PROOF OF EVIDENCE OF DR ANNE STAFFORD & PROFESSOR JEAN SHAOUL

Background to our interest in the scheme

1. We became interested in the Runcorn Bridge as part of our ongoing research into the use of private finance in public infrastructure, known generically as the Private Finance Initiative (PFI) and Public Private Partnerships (PPP). The policy is also known as Design Build Finance and Operate (DBFO) and concessions in the roads sector. Our work has been funded and published by the Association of Chartered and Certified Accountants and the Institute of Chartered Accountants for Scotland. We have looked at the cost and outcomes of transport schemes in general and road concessions in particular both in Britain and internationally, and published separately and jointly in peer reviewed internal journals. We are recognised internationally as authorities on PPPs in general, and roads and hospitals in particular.

The basis of our opposition to the scheme

2. Firstly, our work has consistently shown that the use of private finance for public infrastructure, however the projects are configured financially, adds substantially to the overall cost and this is necessarily reflected in either the charges to the public sector via shadow tolls and availability payments, or the toll charges to users. Even schemes involving user charges usually involve some explicit or implicit public support in order to make them commercially viable and therefore attractive to the private sector. The rationale has usually been that the risk transferred to the private sector justifies the additional cost of private over public finance. But our own and other studies have shown that it is difficult to see what risks have in practice been transferred that justify the additional cost of private finance.
3. When things go wrong, the public sector has either to renegotiate the deal or take it over, picking up the bill for the private sector's debt, which is often significantly larger than the project's construction cost. In essence therefore, when things go well, the public sector and the user pay dearly for 'risk transfer', and when there are problems, the taxpayers and/or the users pick up the tab as risk is spread in unanticipated ways. Either way, such schemes are not a good use of the taxpayers or users' money.
4. Secondly, the lack of clear, consistent and useful financial information is of concern. Our studies have shown that both the public authorities and the companies involved have routinely failed to provide the necessary financial detail both before and after financial close. Furthermore, when pressed under *Freedom of Information* to provide the information that would enable a proper understanding of the costs and benefits to the various parties involved, they hide behind the veil of 'commercial in confidence'. In other words, there is a lack of transparency. The public has every right to believe that where there is a lack of transparency, it is because there is something to hide: the absence of useful

financial information masks the arrangements that privilege the private partner at the public's expense. In any event, the public is paying and they have a right to know about the financial decisions being made on their behalf.

5. There is a lack of evidence demonstrating that the New Mersey Gateway will have the requisite traffic flows to make it both commercially viable and affordable to the public, given the high construction and financing costs. Our analysis of this and other cases suggests that the cost of private finance will add enormously to the overall cost of the project and hence the tolls. It can only be made viable and affordable by some combination of public support and very high toll charges. But high tolls could deter users and make the scheme unviable, leading the concessionaire to hand back the keys and forcing the public authority to assume responsibility for its debt and interest charges, necessarily higher than under public finance. While the public authorities in these types of schemes always start by saying that there will be little or no public support for the project, the financial realpolitik dictates otherwise. Like the Skye Bridge, the government is proposing to make some funds available for this bridge. But like Skye, it could end up paying more than the bridge cost to build in order to support a financially ill conceived scheme. The bridge could be provided much more cheaply, if the government made up the difference, either with a capital grant or public debt, to the benefit of road users and taxpayers alike.
6. Our main proof focuses on the financial costs of the project to the various stakeholders, including financiers, taxpayers and users, of procuring the bridge with private as opposed to public finance.

The Mersey Gateway

7. There are a number of problems that make it difficult to understand the costs. Firstly, while there are many documents relating to the project on the Council's website, it is difficult for an external user to determine the most relevant ones. Secondly, the financial information in the public domain is scanty to say the least, and is insufficient to understand fully how the scheme will operate. Thirdly, the different sources provide inconsistent data that are difficult to reconcile. For example, there is an economic appraisal report and it is not at all clear that it uses the same financial assumptions and data as the project sponsor.
8. This poor, inadequate and inconsistent financial information is itself a cause for concern since it prevents an informed public debate. It is a matter of some concern that KPMG can submit a report stating that it believes the scheme is commercially viable without providing any evidence to demonstrate that this is indeed the case.
9. It is important to understand the source of the problem. The turn to private finance was justified in terms of the value for money to be derived from the greater efficiency and innovation of the private sector and the transfer of some of the risks to the private sector. But the private sector has a higher cost of capital than the public sector, where capital includes both debt, which carries a higher interest charge than government debt, and equity, which requires a higher return than debt because equity capital is perceived as more risky. This is important in

the context of roads and bridges, where the capital as opposed to the operating cost is typically high. The financial viability of such projects depends upon their ability to generate sufficient cash revenues to recover the full costs over the life of the contract, including the cost of debt and equity, under conditions where the demand is rarely sufficient to recover costs. This is after all why most infrastructure and public services have been provided by the state: they are simply too financially risky to be provided commercially on a universal and comprehensive basis.

10. In the context of private finance with user charges, tolls add to both construction and operating costs. Since tolls must cover the cost of debt and equity, the toll charges will be a function of traffic volume and loan period: high volume roads can be repaid within a relatively short period, whereas low volume roads will take longer to repay. Even under conditions of high volumes, political realities may dictate low tolls spread over a longer period. But should traffic flows be low or lower than predicted, then the roads and bridges will operate below capacity, making them difficult to fund. This then necessitates some combination of higher tolls, capital grants and public subsidy. British and international experience has reflected these financial realities. Franchises (Britain) and road concessions (Spain, Mexico and numerous other countries) have had to be renegotiated, bailed out or taken back into public ownership. In the context of Britain, it was these considerations that lay behind the government's original contribution to the capital costs of the Skye Bridge, the high tolls, and the Scottish Executive's subsidy of the tolls, payment of VAT charges and the ultimate decision to terminate the contract.

Financing costs

11. The basis is set out in the main proof, but we estimates that to cover all the costs, operating, maintenance and financing, the toll charges will have to yield a revenue of at least £250m + £1.5bn + several hundred million for maintenance. While there will be public support in the form of PFI credits, at £8m a year, this will not make a significant contribution or difference to the toll charges. Thus the revenues will have to be significantly higher, 50% or so, than Mott Macdonald's estimates, even without any inflation. In terms of toll charges therefore, tolls will have to be greater than the Tunnel charges and higher again due to VAT.

Conclusion

12. It is not clear that the New Mersey Gateway will have the requisite traffic flows to make it both commercially viable and affordable to the public. The evidence suggests that the cost of private finance will add enormously to the overall cost of the project and hence the tolls. This is particularly egregious, since like Skye, the government is proposing to make funds available for the bridge. The bridge could be provided much more cheaply, if the government made up the difference, either with a capital grant or public debt, to the benefit of road users and taxpayers alike.