

LAND OF THE ROBBER BARONS

Carillion's collapse was symptomatic of a process that will be stopped only by jailing kleptocrats, says Trevor Smith

The sudden liquidation of the previously little-known but vast outsourcing conglomerate was as spectacular as the ensuing ramifications will be enduring. Carillion, founded in 1999 out of a group of merged firms, including some household brands, carried on absorbing others. At the time of its demise there were some 43,000 employees, of whom 20,000 were in the UK.

The dimension of the downfall itself is bad enough, but the factors which led up to it are even graver. If these are not fully identified for what they are and dealt with, they will continue at work. Or, as before, will they be papered over?

Media commentators regularly report on the deleterious effects of both Jacob Zuma's cronyism in South Africa and oligarchs in Vladimir Putin's Russia. The widespread kleptocracy is closely identified with the regimes. In stark contrast, in the UK kleptocracy is regarded as a series of one-off discrete events rather than being in any way systemically endemic which, of course, it is just as in the other two states.

The different media treatment arises because the situation in the UK has evolved much more slowly over decades. (In South Africa and Russia corruption has festered uninterrupted by official action because those in authority have actively participated in it themselves.) In the UK, kleptocracy emerged alongside the increasing retreat of ministerial responsibility since the end of WWII. Both factors made it so much easier to camouflage what was happening.

MINISTERS RETREAT

Ministerial retreat began with the invention of the 'Morrisonian' public corporation to run utilities nationalised by the Attlee government. Unlike the General Post Office, which came under direct ministerial control, cabinet members would be at arms-length from the boards of the public corporations charged with the day-to-day running of the state industries. On returning to office in 1951, the Tories continued the practice as part of the mixed economy consensus which The Economist termed 'Butskellism' (a compound of the surnames of successive Chancellors Gaitskell and Butler).

In the mid-1950s this gave way to the new consensus of the two Harolds (successive prime ministers Macmillan and Wilson) following the example of the French Fifth Republic's introduction of indicative planning. This necessitated cabinet ministers sharing power with representatives from the trade unions and industrial organisations through a number of tripartite channels at the apex of which was the National Economic Development Council. Neddy, as it became called, although losing much of its influence over

time, even managed to survive during the wholesale Thatcherite privatisations of the nationalised industries.

Privatisation was purported to reintroduce the discipline of market forces to control the public utilities but, in the event, it did no such thing. It merely created a series of monopolistic cartels (ironically often part-owned and controlled by state undertakings from abroad). The reality was tacitly recognised when an army of regulatory agencies was empanelled to oversee the running of these entities.

Privatisation was all part-and-parcel of a new consensus that took it as axiomatic that private=good, public=bad. This formula led to a widespread series of innovations that would still further distance ministerial authority from the formation and execution of public policy.

One of the most visible was the invention of private schemes to finance and administer erstwhile government-run activities. The first private finance initiative (PFI) was employed for the Heathrow Express, providing a fast line from Paddington to Heathrow Airport. This at least had the merit of generating a positive cash flow.

On assuming office, New Labour had no qualms about earnings, as it embraced the PFI concept with a messianic fervour. PFI schemes were extensively used to build a plethora of prisons, hospitals, schools and other erstwhile public services. PFIs were drawn up by coterie of engineers, architects, accountants, lawyers, builders and other commercial firms that negotiated with government. The claimed advantages of PFIs were that they would make for faster provision, provide better expertise and spread the costs to the public exchequer more evenly over time.

Usually, PFIs had an operational span of 30 years, during which time they would re-coup start-up costs and continuing service charges from the taxpayer. The latter were very highly calculated, especially when changes were required as would be very likely over three decades. In the event, these costs have crippled the finances of almost all major health authorities.

PFIs were to prove disastrous in many more ways. First, if they failed, as some did as in the case of the Hinchingsbrooke Hospital, the public had to assume responsibility.

Secondly, the contracts were drawn up in secret, thus avoiding public scrutiny. Thirdly, original contractors were often bought out by other enterprises and a secondary market in PFIs soon developed. Neither made for ease of ensuring contractual compliance which was exacerbated still further when PFI firms outsourced necessary service to secondary suppliers.

The very unsatisfactory start of PFI schemes was at the root cause of the difficulties experienced. The civil

service lacked the necessary skills to negotiate the contracts. Whitehall had to call upon outside expertise from accountants, lawyers and other consultants to facilitate PFI provision. This, inevitably, involved recruiting such experts on the 'revolving door' principle whereby sometimes they would be acting on behalf of government while on others they would be involved with would-be PFI contractors which could include themselves. PFIs were a new, highly lucrative growth industry for those involved; little heed was paid to safeguarding the public interest – and least of all on the part of Ministers themselves who continued to abnegate from their responsibilities.

But worse was yet to come. The axiomatic private=good, public=bad consensus led to a much more ubiquitous phenomenon, the knee-jerk recourse to outsourcing. Like the regulatory agencies and the PFI merchants, outsourcing has spawned its own cartel, which includes Serco, Capita, G4S as well as Carillion.

The so-called 'night watchman state' held sway in the mid-nineteenth century but even its most rampant advocates drew the line at what should be retained as strictly state activities. Home security – including police, prisons and the administration of justice, the conduct of foreign affairs and defence would be the sole preserves of government.

Nowadays, the incursion of privatised outsourcing into these traditional activities is a commonplace; mercenaries abound. As the armed services have shrunk, so security firms have been brought in, even on the front lines in Iraq and Afghanistan. Many prisons are now built and run by private firms who employ their own warders. The Probation Service now includes private employees, many without qualifications, while greater reliance on private firms for forensic analysis has had its own disasters.

Legal Aid has been drastically reduced so that the courts are overwhelmed with actions brought by individuals with little knowledge of the law or its procedures. And, to cap it all, it is reported that senior British diplomats are often seconded to private PR firms working for foreign governments, the latest example being Saudi Arabia. The scale and extent of outsourcing is mind-boggling.

Another deleterious consequence is that traditional forms of accountability have been under severe threat and can no longer be relied upon to serve the public interest.

First, the statutory position of shareholders as the ultimate repository of overall control of commercial companies has long been largely a fiction which enabled the rise of a new breed of robber barons among chief executives. The advent of electronically traded funds, which are triggered algorithmically to buy and sell shares often for nanoseconds, further weakens shareholder power. Company law needs a complete overhaul to up-date its remit.

Secondly, professional accountancy firms have also failed in many respects. Deloitte, PWC, E&Y and KPMG (Carillion's auditor throughout its existence), the so-called 'big four' form yet another of the cartels that litter the firmament of contemporary commerce. As statutory auditors they have never once qualified the annual accounts of a FTSE 100 firm. They share in providing internal accounting and more general consultancy advice to these firms. As in the Carillion case all four received very high fees for

over a decade. The situation has long called out for close investigation. Journalists, MPs and financial regulators are beginning to give it the attention it needs. At the minimum reforms should include requiring statutory auditors to be completely divorced from other accountancy and consultancy services, together with splitting up the 'big four' so that choice can be enlarged with more auditors to bid for such work.

GROSSLY EXCESSIVE

One of the main reasons for the collapse of Carillion must lie in the kind of top executive remuneration packages paid nowadays. They have become grossly excessive and the differential between these packages and those of the average worker continue to widen. Often, these extortionate payments bear little relation either to individual or overall corporate performance. Despite recent critical mutterings, including some shareholder adverse votes, there is little sign of much abatement in outlandish payments being awarded across the scene. These play to the greed of chief executives and their senior colleagues and this only encourages mergers and acquisitions to enlarge their range of duties thereby increasing still further their rewards. Thus, mergers and acquisitions are pursued relentlessly despite research having shown for well over 50 years that the results frequently do not live up to expectations even when they are carefully planned. How much greater, then, must be the failure rate when additions are made in an almost mindless manner as in the case of Carillion?

The conglomerate grew to the point that it was beyond the intellectual capacity of any one individual or group of individuals to comprehend what was happening. As things increasingly got out of hand, very questionable remedies were sought by its directors. These included, delaying payments due to suppliers, not paying in to pension funds (Carillion's was £580m in deficit) or borrowing from them, seeking new contracts (even when loss-making) and unsecured bank credits and other such baleful methods in attempts to keep the show on the road. In the end time ran out and the inevitable occurred as with the 2001 collapse of Enron.

How many more disasters will have to occur before the realisation dawns that the condition of British capitalism is now so very parlous and in need of comprehensive examination and subsequent radical reform to render it fit for contemporary commercial activity?

Many more criminal prosecutions of the most senior staff must be activated. Fining corporations, though equally necessary, merely takes more shareholders' money - swingeing prison sentences, as in the Madoff and Enron atrocities, are the only way to reduce outright fraud and/or gross derelictions of duty. The UK authorities have been most reluctant to institute such proceedings.

The betting must be on the continuing and cowardly retreat of ministerial responsibility and further postponement. Carillion will not be the culmination but merely yet another staging post on the road to engulfing catastrophe with all the enormous difficulties that will be imposed on both the economy and polity alike.