Greed of the highest order

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From the hubbub surrounding the privatisation of the British government's defence research service, Qinetiq, last week, one statement stopped me dead. Lord Drayson, the minister for defence procurement, asserted that it was a "good model for future privatisations". Three things hit me. The first was that Lord Drayson is minister for defence procurement. This remarkable fact had until then passed me by. The second was that, if the government really is envisaging further privatisations, this is the first we've heard of it. What else did Drayson have in mind? Is there anything that hasn't been sold already? The third was that, with the exception of the privatisation of the railways in 1996, it would be hard to think of a worse model for a government sell-off.

As everyone now knows, Friday's flotation of Qinetiq raised the value of the shareholding acquired by Carlyle, the US investment firm, by around 840%. Carlyle, whose board is graced, among other eminences, by former prime minister John Major, bought its stake at auction in 2002 when the stock market had floundered. It paid £42m for a 31% share, which at close of play on Friday was worth around £351m. Last week, it flogged over half its shares. Its chairman, who paid £129,000 for his stake in the company, is now worth £27m, and its chief executive £22m.

As it was with the four directors of Rover (who walked off with £40m), it is hard to see what they did to deserve it. As Lord Drayson's Labour predecessor, Lord Gilbert, pointed out: "All the value was built up by public servants using public money. I consider it a complete outrage ... a scandal." In a letter to the Daily Telegraph on

Saturday, the former managing director of the Defence Research Agency – the government body that was split up and turned into Qinetiq – described the profits as "greed of the highest order": the two men, he said, had captured the benefits of decades of work by its scientists and engineers.

Lord Drayson's boss, the defence secretary John Reid, claimed that the company is worth so much "because of the value that has been added there" by Carlyle's management. "This is precisely why [we] brought them in." But if the government knew that Carlyle would make so much money, why did it allow the company to buy its stake so cheaply? If it didn't know, then why should we take its counterfactual accountancy seriously? In fact, in 2002 the government was warned by Lord Gilbert and Lord Moonie, who was defence procurement minister when Carlyle bought its stake, that the taxpayer was being shortchanged. Moonie says he was overruled by the Treasury. The government went in with its eyes wide open.

One could argue that much of Qinetiq's value was added not by the brilliance of its directors, or even of its engineers and scientists, but by a huge contract with the Ministry of Defence, signed on the very day (February 28 2003) that Carlyle paid for its stake. The "Long-Term Partnering Agreement", under which Qinetiq manages the government's firing ranges, is worth £5.6bn over 25 years. In fact, with a contract such as this, any one of us could have bought that 31% stake without having to open our wallets: you could borrow the money, at cheap rates, against your guaranteed future income. Carlyle admits that it underwrote part of the capital by refinancing its revenues on the basis of the contract. The Guardian has also reported that Qinetiq might have left behind some potential liabilities during the flotation: the government may have to carry the costs of cleaning up some land it has been using.

To anyone who has studied the private finance initiative, this story – of guaranteed assets and reduced liabilities – will be familiar. Qinetiq's sale carries fewer public dangers than the part-privatisation of our schools, hospitals and whatever else remains of the public sector, as the potential liabilities are much smaller, and the impact of the possible misdrafting of the long-term contract less consequential. But it seems clear that these generous provisions fattened up the company for privatisation. As Lord Gilbert says: "The MoD was taken like a lamb to the slaughter."

In the past, ministers have sought to justify deals such as this on the grounds that corporate profits are good for the exchequer. But they would struggle to apply this argument to the privatisation of Qinetiq. Carlyle bought its stake through a series of "special purpose vehicles" based in Guernsey, which means that it will not be paying tax on the sale of its shares. It says that the government knew it would be using the tax haven before the deal was done. In this respect, the Qinetiq story has some parallels with the sale of the Inland Revenue's properties to Mapeley – an investment company registered in Bermuda.

As for Lord Drayson, I was staggered by his appointment not because I believe that he has had too little experience of this branch of government, but because I believe he has had too much. Before he took office, Paul Drayson knew quite a lot about defence procurement: he had pulled off a substantial deal with the MoD.

Until 2003, when he sold it for £542m, Paul Drayson was chief executive of a pharmaceutical company founded by his father-in-law, called Powderject. He remains a generous donor to the Labour party. After 9/11, the British government decided to stock up on smallpox vaccine. On November 30 2001, the MoD decided that the kind of vaccine it wished to buy was the Lister strain. The only company that possessed sufficient stocks was a German-Danish firm, Bavarian Nordic. On December 6 2001, Paul Drayson, with a few other businessmen, was invited to breakfast at Downing Street. Soon after that, government officials visited Bavarian Nordic to open negotiations to buy the vaccine. They were told that it was too late: Powderject had just bought the exclusive distribution rights for the UK. If the government wanted the Lister strain, it would have to buy it from Drayson's company. The government paid Powderject £32m for the vaccines, of which £20m seems to have been profit. The Guardian tried to ask both Tony Blair's office and Paul Drayson whether the Lister strain had been discussed at the breakfast in Downing Street, but neither of them would comment. It is not known whether Drayson became aware of the government's intentions at that meeting.

In May 2004, Tony Blair made Paul Drayson a life peer. This also attracted controversy: six weeks after he received his peerage, he gave the Labour party £500,000. In May 2005, he joined the government. Since then he has been responsible for ensuring that the MoD receives good value from its contracts with private companies.

So here we have a privatisation – the first full-scale privatisation Tony Blair's government has carried out – that has allowed a US investment company to walk off with hundreds of millions of pounds of free money, much of which will be tax exempt. It has been assisted by 25 years of guaranteed income from the government and the possible shedding of liabilities. It is overseen by a man who first came to public notice as a result of a defence procurement deal surrounded by controversy, and who now turns up as minister for defence procurement. Does anyone agree that this is a "good model for future privatisations"?