FINANCE COMMITTEE

AGENDA

4th Meeting, 2007 (Session 3)

Tuesday 25 September 2007

The Committee will meet at 2.00 pm in Committee Room 1.

1. **Abolition of Bridge Tolls (Scotland) Bill:** The Committee will take evidence on the Financial Memorandum of the Abolition of Bridge Tolls (Scotland) Bill from—
   - Alastair Andrew, General Manager and Bridgemaster, and John Connarty, Treasurer, Forth Estuary Transport Authority;
   - David Dorward, Treasurer, Tay Road Bridge Joint Board;
   - and then from—
   - David Patel, Deputy Director, David Dow, Financial Advisor, and Christopher Rogers, Head of Branch, Transport Directorate, Scottish Government.

2. **Decision on taking business in private:** The Committee will decide whether to consider a draft report on the Financial Memorandum of the Abolition of Bridge Tolls (Scotland) Bill in private at future meetings.

3. **Inquiry into the methods of funding capital investment projects:** The Committee will consider its approach to the inquiry.

4. **Smith Institute Seminars:** The Committee will consider an invitation from the Smith Institute, in association with the Institute of Fiscal Studies to the Convener to attend a seminar on Fair Tax.

Susan Duffy
Clerk to the Finance Committee
Room T3.60
Ext: 85215
Email: susan.duffy@scottish.parliament.uk
The papers for this meeting are as follows—

**Agenda item 1**

PRIVATE PAPER

Submission from the Forth Estuary Transport Authority

Submission from the Tay Road Bridge Joint Board (to follow)

Members should bring with them the Abolition of Bridge Tolls (Scotland) Bill and accompanying documents. These were circulated in hard copy to Members previously and are available on the Scottish Parliament website at:


**Agenda item 3**

Approach paper by the clerk and SPICE

**Agenda item 4**

Note by the clerk

**Forthcoming Committee Meetings—**

Tuesday 23 October, Committee Room 6;
Tuesday 30 October, Committee Room 2;
Tuesday 6 November, Committee Room 4;
Tuesday 13 November, Committee Room 5;
Tuesday 20 November, Committee Room 1;
Tuesday 27 November, Committee Room 2.
Finance Committee

4th Meeting, 2007 (Session 3), Tuesday 25 September 2007

Abolition of Bridge Tolls (Scotland) Bill

Submission from Forth Estuary Transport Authority (FETA)

FETA’s number one priority is the continuing safe maintenance and operation of the Forth Road Bridge. At present this is entirely funded by toll income approaching £12m each year. Before this income stream is removed, a financial settlement must be agreed that safeguards the integrity of this vital transport link for the years to come.

The Forth Road Bridge is the oldest long-span suspension bridge in Europe, and FETA’s experienced staff understands its unique maintenance requirements. Routine maintenance and inspection goes hand in hand with a rolling 15-year programme of capital works and capital expenditure can vary considerably from year to year.

It is difficult to predict future bridge maintenance requirements. For example, the introduction of new codes on structural assessment resulted in unforeseen strengthening works to the main towers totalling £12.7m; consideration of a ship impact risk evaluation required the provision of pier defences costing £9.9m; following an unexpected failure and subsequent extensive testing, it was necessary to replace all hanger ropes at a cost of £8m; and, following internal inspection of the main cables, FETA is installing a system of dehumidification at an estimated cost of £10m.

The uniqueness of the work can also mean significant differences between estimated and actual costs of contracts. For example, strengthening works to the towers were estimated to cost £9.7m, but the actual cost was £12.7m; ship impact defences were estimated to cost £7.4m, but the actual cost was £9.9m. Currently, contracts estimated at £10m for bearing and joint replacement and £65m for suspended span painting are still to be awarded.

Current studies being undertaken include off-site testing of the vehicle parapets which were provided before the emergence of a British Standard on containment, the proving of the structural integrity of the cable anchorages and the feasibility of replacing the main suspension cables in the event that the de-humidification project fails. These three schemes have the potential for further major expenditure.

History shows that most capital works on the bridge are delayed by adverse weather and that even experienced contractors tend to under-estimate the effects of working at height, in the exposed environment of the bridge.

As Parliament seeks to replace toll revenue, it is vital that a flexible financing structure is established that takes into account the unique, variable, long-term nature of the Bridge’s maintenance programme.
Current position

FETA is broadly satisfied with the terms of the financial memorandum appended to the Abolition of Tolls Bill:

- Ministers intend to replace the toll income with direct grant funding.
- The grant estimates contained in the financial memorandum are consistent with FETA’s approved financial plan and include provision for the one-off costs of toll plaza remodelling and staff severance payments.
- The memorandum indicates that FETA will be able to hold a reasonable reserve and have the ability to borrow in exceptional circumstances.
- There is a commitment to work on a detailed agreement with FETA.

Having said that, we will be seeking clarity from the Scottish Government on a number of issues including:

- Detailed grant conditions, including flexibility between years.
- The process to adjust grant where costs vary from estimates or where unforeseen work is required.
- How borrowing powers will operate in practice.
- The definition of reasonable reserve.
- A longer term commitment beyond the 3 year period of the Government Spending Review when required.
- How the Scottish Government will provide security of future income to FETA where the Authority wishes to invite tenders for works which include significant financial commitments beyond 3 year Spending Review period.

Alastair Andrew, General Manager, Forth Estuary Transport Authority
John Connarty, Treasurer, Forth Estuary Transport Authority
Finance Committee

4th Meeting, 2007 (Session 3), Tuesday 25 September 2007

Abolition of Bridge Tolls (Scotland) Bill

Submission from Tay Road Bridge Joint Board

The Financial Memorandum of the Bill sets out the future funding proposals for the Tay and Forth Road Bridges after the bridge tolls are abolished.

It should be stressed that the figures currently quoted in the Financial Memorandum are based on financial information supplied to the Scottish Executive by the Tay Road Bridge Joint Board on 6 August 2007. Since that date some of the assumptions on which the Tay Road Bridge officers submitted the figures have changed and one of the purposes of this written evidence is to provide an update on those assumptions.

The Financial Memorandum assumes a one-off capital grant of £14,763m to repay the estimated total outstanding loan debt as at 31 December 2007. I can confirm that the figure of £14.763m included in the Bill's Financial Memorandum would be sufficient to clear the Tay Road Bridge Joint Board's outstanding loan debt at 31 December 2007.

In terms of the estimated annual capital grants figures included in the Bill's Financial Memorandum, these have now changed due to the Bridge Engineer and Treasurer reviewing the Bridge Board's Capital programme. The following table details the previous and proposed annual capital grants:-

<table>
<thead>
<tr>
<th>Year</th>
<th>Financial Memo Grant</th>
<th>Revised Proposed Grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007/08</td>
<td>1,537</td>
<td>1,698</td>
</tr>
<tr>
<td>2008/09</td>
<td>7,190</td>
<td>1,225</td>
</tr>
<tr>
<td>2009/10</td>
<td>6,625</td>
<td>8,020</td>
</tr>
<tr>
<td>2010/11</td>
<td>2,265</td>
<td>6,915</td>
</tr>
</tbody>
</table>

|               | 17,617                | 17,858                 |

The reasons for this movement in capital spend are firstly that additional Bearing replacement work has been identified in the current financial year 2007/08, and secondly the Pier Collision Protection work has been rescheduled to start in 2009 rather than 2008.

In terms of the resource grant figures included in the Bill's Financial Memorandum, these will also need to be revised to reflect more up to date information, particularly in respect of the Bridge Board proposed staffing structure. The resource grant figure required for 2007/08 is lower due to a more realistic estimate of expenditure required for toll booth removal and the
erection of new signs. The following table details the previous and proposed annual resource grants.

<table>
<thead>
<tr>
<th>Year</th>
<th>Financial Memo Grant</th>
<th>Revised Proposed Grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007/08</td>
<td>850</td>
<td>553</td>
</tr>
<tr>
<td>2008/09</td>
<td>1,208</td>
<td>1,474</td>
</tr>
<tr>
<td>2009/10</td>
<td>1,235</td>
<td>1,508</td>
</tr>
<tr>
<td>2010/11</td>
<td>1,262</td>
<td>1,544</td>
</tr>
</tbody>
</table>

The conclusion on the figures included in Bill's Financial Memorandum is that they will have to be amended to reflect the more up to date information provided by the Tay Road Bridge Joint Board.

In terms of the principles behind the proposed future funding for the Tay Road Bridge Joint Board, the proposals included within the Bill's Financial Memorandum are generally acceptable. The combination of a one-off grant to repay the outstanding loan debt and annual capital grants should effectively mean that the Board will have no need to borrow and therefore have no future loan debt. The proposal to eliminate the 2016 debt repayment deadline, and leave the Board with its borrowing papers, will effectively provide the Board with a fall-back facility should the annual capital grant ever prove insufficient. The annual resource grant should be sufficient to meet the Board's annual running costs, however if actual annual spend ever exceeds the grant, then the Board will be able to meet any such excess from the residual General Reserve balance of circa £500,000. In my opinion the funding principles as set out in the Bill's Financial Memorandum are acceptable and sufficient for the Board's future funding requirements.

David K Dorward
20 September 2007
Finance Committee

4th Meeting, 2007 (Session 3), 25 September 2007

Inquiry into Methods of Funding Capital Investment Projects – Remit and Programme

Note by the Clerk

Introduction

1. At its meeting on 11 September 2007 the Committee agreed to conduct an inquiry into the methods of funding capital investment projects.

2. The enclosed briefing paper from SPICe provides some background on various funding models and the debate generated around them. It also suggests an initial remit for the inquiry.

3. There has been no detailed Parliamentary scrutiny since 2002 of the Executive’s approach to capital project procurement. This inquiry, therefore, gives the Committee the opportunity to provide a focus for the current debate about funding methods, and influence the development of policy at a time when this issue has a particularly high profile.

4. This paper invites the Committee to consider a more detailed proposal for the inquiry, including a proposed remit and outline programme of evidence.

Proposed outline timetable

5. The Committee has agreed to give early consideration to this inquiry in the autumn, with a view to devoting time for evidence-taking in the first half of 2008, once the formal consideration of the 2008-09 Draft Budget is completed. It is, therefore, suggested that the Committee may wish to make some initial decisions about the shape of the inquiry so that it can be launched now. The Committee can then return to it after the budget scrutiny to agree a detailed evidence programme for the rest of the inquiry in the light of any developments which have taken place in the autumn.

6. The Committee is invited to consider the proposed timetable.

Remit

7. If the Committee agrees to launch the inquiry now, members may wish to agree a fairly broad remit for the inquiry at present. This can then be refined to provide a focus for the evidence programme at a later date in light of issues raised in any submissions received.

8. The Committee invited to consider the following suggested initial remit for the inquiry:
“The Committee has decided to examine the funding of public capital investment projects. The inquiry will consider and report on the advantages and disadvantages of different models. This can include the implications of the different models for costs and for the management and public benefit of the projects.”

Written evidence

9. It is suggested that the Committee may wish to launch the inquiry as soon as the remit and outline programme have been agreed. It is proposed to launch the inquiry by issuing a news release and call for written evidence, seeking responses by Friday 7 December. The news release and call for evidence will be based on the terms of the initial remit. This would appear on the Parliament’s website and could also be sent directly to key media outlets and relevant organisations. Clerks and SPICe will work together with the Media Office to ensure that it has as wide a circulation as possible.

10. A web page for the inquiry will also be set up on the Committee’s home page, showing the remit and timetable etc, and encouraging interested parties to submit evidence. This web page can be updated throughout the inquiry.

11. The Committee is invited to agree this approach to written evidence.

12. Given the Scottish Government’s announced intention of significantly changing its preferred procurement approach, the Committee may wish to consider carefully how its remit, timetable and evidence programme for this inquiry may sit alongside any developments expected in the Scottish Government’s policy on a Futures Trust. The Committee is, therefore, invited to consider whether it wishes to write to the Cabinet Secretary now asking for as much detail as possible about the scope and likely timetable for this development.

Adviser to the Committee

13. Given the technical complexities of such an inquiry, the Committee may wish to consider appointing an adviser for the duration of the inquiry. (Prof David Bell is engaged by the Committee to provide advice on its budget scrutiny work only.)

14. If the Committee decides in principle to appointing an adviser, SPICe researchers will produce a short-list of candidates from the Parliament’s database of advisers for a future Committee meeting from which members will be asked to select their preferred candidate. Members will also be asked to agree a specification for the adviser. The necessary approvals will then be sought from the Bureau and the SPCB. The aim would be to have an adviser in place before the Committee’s call for evidence closes, so that the adviser can assist the Committee in refining the focus for the inquiry and planning appropriate evidence sessions and any fact-finding visits.
15. The Committee is invited to consider whether it wishes to agree in principle to seek to appoint an adviser for this inquiry.

16. The attached briefing paper from SPICe gives an initial outline of the subject. However, the Committee may wish to request a more detailed briefing paper on the different funding models. SPICe researchers, along with any adviser, could be asked to prepare this briefing with a view to members being able to consider it before deciding on an oral evidence programme. In addition, it may be useful for the Committee to consider what the evidence from around the world tells us about funding public capital projects.

The SNP (2007) Scottish Futures Trust document states that:

“Recently the state of New York issued $270 million in 30-year bonds to fund policy projects, correctional facilities and state office buildings. With a triple A Standard & Poor’s rating, this is a much more efficient source of capital than Scotland currently has access to through PFI. In fact, all 50 American states have the ability to issue debt – including states like Wyoming, Rhode Island and North Dakota that each has a population of less than 1 million people. Similarly, each province in Canada has this ability.”

The detail of such research could be worked up by SPICe and the adviser in the paper outlined above. **Members are invited to consider if they wish to have a further paper on different funding models and the funding of public capital infrastructure in various jurisdictions throughout the world. Suggested case studies from members are welcome.**

**Oral evidence programme**

17. The Committee is invited to agree to defer detailed consideration of an evidence programme until a meeting early in the new year (i.e. after it has completed scrutiny of the Draft Budget 2008-09). It is anticipated that, by that time, the Committee will have access to additional information to help inform decisions about oral evidence.

18. Written submissions received in response to the call for evidence would be circulated after the closing date so that they could be reviewed by members before considering a proposed oral evidence programme. Any adviser appointed by the Committee may be able to produce an analysis of these submissions.

19. The Committee may be able to dedicate time to take oral evidence at a number of meetings in the period January-June 2008, perhaps grouping two or three meetings at a time around different themes of the inquiry. The complex and wide-ranging nature of capital investment issues may provide a suitable opportunity for a slightly different approach to oral evidence from normal. For example, the Committee may wish to consider the option of using round-table discussions or other events to generate a more open style of discussion with a variety of witnesses, rather than the traditional question-
and-answer format with separate panels. Equally, a more detailed briefing paper may indicate that it may be effective to organise fact-finding visits as part of the inquiry. A paper with detailed options for taking evidence can be brought to the Committee early in the new year. In the meantime, the Committee is invited to agree, in principle, this approach to an oral evidence programme.

Witness expenses

20. Witnesses called by a committee are entitled to claim certain expenses and a committee is required to decide whether each claim should be paid. A committee may delegate authority to the Convener to decide whether any claims arising from an item of business should be paid. The Committee is therefore invited to consider whether the Convener should be delegated authority to decide on any claims arising from this Inquiry.

Summary

21. The Committee is invited to agree arrangements for this inquiry. In particular, the Committee is invited to agree:

- the proposed outline timetable and initial remit for the inquiry
- to issue a news release and general call for written evidence
- whether to write to the Cabinet Secretary seeking details on the timetable and scope for development of the proposed Scottish Future’s Trust
- whether it wishes to agree in principle to seek to appoint an adviser for this inquiry
- whether to request that SPICe (and any adviser) prepare a more detailed briefing paper on the different funding models
- the approach to developing an oral evidence programme
- to delegate to the Convener the authority to approve any claims under the witness expenses scheme arising from this inquiry.

Mark Brough
Senior Assistant Clerk to the Committee
FINANCE COMMITTEE

SCOPING PAPER FOR CAPITAL INVESTMENT INQUIRY

This paper scopes some of the terrain that might be covered by a Finance Committee inquiry into the funding of capital investment. It provides background, explores the various funding methods to have developed in recent times and the debate this has generated, before raising some issues and developments which members may be aware of.

BACKGROUND

At its away day, the Finance Committee agreed to undertake an inquiry looking at the funding of capital investment projects in Scotland. The background to this proposed inquiry topic is the debate emerging on how best to fund capital investment projects in Scotland.

The SNP in its election manifesto proposed a “Scottish Futures Trust” as an alternative to the Private Finance Initiative (PFI) model of funding capital investment. Detailed proposals have yet to be published, but an SNP policy document (SNP 2007) published during the recent election campaign, proposed “greater use of public bond issues so that our public services can have access to lower cost borrowing….without the unnecessary private profit that is an integral part of PFI.”

This inquiry proposes to look at the PFI model as well as alternative methods of capital investment, including the initial proposals from the new government. Although the detail of the new government’s plans is still unclear, the principle of issuing government bonds as a method of funding capital investment will be considered.

THE PROBLEM WITH FUNDING CAPITAL INVESTMENTS

Until the middle of the 1980s, the public sector was expected to be responsible for all aspects of the design, financing and operation of public sector capital projects. Although the private sector was often involved in these projects as a contractor (usually in connection with the construction of buildings, roads and other infrastructure facilities), the final responsibility for project delivery rested with the public sector. Generally speaking, private contractors would bid against each other for a part of the package of work identified by the public sector, or professional advisers working on behalf of the public sector.
Over time, some deficiencies emerged with this particular model of capital infrastructure delivery. Problems included: failure to bring projects in on time and on budget; the changing of specification of contracts during the construction process, thereby incurring additional costs; and the fact that the contractor had little commitment to the project beyond completion of the work for which they had contracted, which often had the effect of increasing longer-term operating and maintenance costs.

In addition, when faced with financial constraints, central and local government would typically sacrifice investment in new and replacement capital projects and the maintenance of existing capital infrastructure in order to protect budgets which underpinned the day-to-day delivery of public services. This led to a protracted period of under-investment in new schools and hospitals, in transport and other public infrastructure projects, and a relative decline in the quality and quantity of the UK’s public infrastructure.

These problems identified with funding capital investment led to the UK government exploring alternative methods of funding capital investment projects, which are explored in more detail below. One such method was the PFI.

**PUBLIC FINANCE INITIATIVES**

**What are PFIs?**

Public Private Partnerships (PPPs) cover a wide range of institutional arrangements in which the public and private sectors work together, including PFIs, joint ventures and concessions, and the outsourcing of public services. A common form of PPP, under which many capital investment projects have been undertaken in recent years, is the PFI.

Under a PFI, the private sector service provider is responsible not only for asset delivery, but for the overall project management and implementation for a number of years after. The private sector provides the finance for the construction of the asset and the public sector repays the private company a regular fee covering agreed capital and maintenance costs, once the building is ready for use. The fee may be fixed or may vary with use. Ownership of the infrastructure asset usually remains with the private company until the end of the term of the contract, typically 25-30 years, when, in the majority of cases, ownership of the asset transfers to the public sector. The contract for the project also defines who bears the risk. Any project will have a number of associated risks and these should be priced appropriately. Under PFIs greater risks, such as possible cost over runs and lower than expected usage are normally passed to the private sector.

Proponents of the PFI argue that it offers a means to deliver a greatly accelerated infrastructure provision by translating the costs of the expenditure – which would normally be scored as expenditure in the years in which it
occurred – into a flow of ongoing service payments spread over the period of the contract. The argument is that investment can then be brought forward by leveraging in private sector finance without impacting on control over public sector borrowing, which governments have traditionally seen as a key lever in their economic strategy. This method of funding capital, therefore, is seen as a way of obtaining additional infrastructure investment without threatening current budgets.

The case for PFIs

Some of the arguments made in favour of the PFI are as follows:

- By spreading payments over a period of time, it allows more capital infrastructure projects to be funded, at least in the short term, than would otherwise be the case
- By transferring the risk of delays, cost overruns and performance shortfall to the contractor for an extended period it reduces costs for the public sector
- It provides incentive for delivery of project on time and on budget
- It encompasses a wider skill base from both the public and private sector
- The quality of the infrastructure must be maintained which encourages the private contractor to avoid cutting corners
- PFI transactions can be “off-balance sheet” therefore removing the need to increase public borrowing to pay for capital investment

The case against PFIs

Opponents of the PFI argue that the expected benefits of the PFI have not been achieved and that rather than being value for money, PFI deals have been more expensive than traditional public sector methods.

Some of the arguments made against the PFI are as follows:

- Public sector may lack the expertise for partnership with the private sector; and the private sector may lack the expertise for partnership with the public sector
- It is not always possible to transfer life cycle risks to the contractor at a reasonable cost
- Loss of management control by the public sector
- The procurement process can be lengthy and costly
- The private sector has a higher cost of capital than the public sector
- Contracts can be too long-term and inflexible
ALTENRATIVES FOR FUNDING CAPITAL INVESTMENT PROJECTS

There are a number of alternative models of managing and funding investment in large scale public sector capital projects. These are considered below.

The Scottish Futures Trust

We await details of the new government’s proposed Scottish Future’s Trust, but the SNP election manifesto provides some information on the new government’s thinking in this area. The proposal is essentially to allow the Scottish government to borrow funds for investment in infrastructure by issuing bonds. Interest paid on the bonds would be tax free. The manifesto proposal also links the plans for the Futures Trust with the SNP plans for a Scottish Oil Fund. The intention, if the Scottish government receives powers to establish an oil fund, would be to allow a proportion of Scotland’s oil revenues to be invested in the bonds.

At the time of preparing this paper, work on the Scottish Futures Trust was in progress but, as yet, there is no date for an announcement.

Members should also note that while the SNP hopes the introduction of the Scottish Futures Trust “crowds out” the PFI model, the government envisages that local authorities will retain the discretion to choose how it bests delivers its infrastructure programmes. In a PQ response of 20 June (S3W-891), Cabinet Secretary Swinney stated:

“John Swinney: We said before the election that it will be open to local authorities and other public bodies to choose between PFI and Scottish Futures Bonds for planned and future projects. Work has already started on the detailed design aspects of the Scottish Futures Trust and a further announcement will be made when we are ready to explain it in more detail. We will ensure that replacement arrangements are robust and taken forward with the confidence of both public and private sectors.”

Given this position of the government, a Finance Committee inquiry into the funding of capital projects can contribute to what is a “live” debate where Councils will have to chose how best to fund infrastructure projects. Other methods of managing and funding capital are presented below.

Not for profit model

Argyll and Bute Council was the first council in Scotland to pioneer the so called Non-Profit Distributing Organisation (NPDO) model of managing capital investment projects, when it launched such a scheme for funding improvements to the school estate. This is a form of PPP model and as such the previous and current government provides such models with revenue support. Under this model, a NPDO is set up, with the private sector making a
profit at the sub-contractor level, with all other profits being recycled back into education service provision via the NPDO.

Other recent examples of this not for profit model have taken place in Falkirk and Aberdeen. In Falkirk, all the profits from the non-profit organisation must be re-invested in the schools or the local community. Each school has a board with community, private sector and staff representatives who will decide how the profits are reinvested. The private sector has a majority on the board.

The Financial Partnerships Unit at the Scottish Government has said that the not for profit model “could have advantages over other forms of PPP by delivering marginally lower costs of financing and allowing greater stakeholder involvement” (Financial Partnerships Unit, 2007).

The not for profit model appears to appeal to the new Scottish Government. In a response to a PQ, Cabinet Secretary Swinney (20 June 2007, S3W-891) stated:

“Until the Scottish Futures Trust is introduced, we are considering the scope to move to Non-Profit Distributing (NPD) forms of PPP where NPD surpluses are returned to the community providing a better balance of public/private interests.”

Prudential Borrowing

Local authorities used to be subject to controls on their levels of capital borrowing. However, the Local Government in Scotland Act 2003 repealed the relevant legislation and introduced the “prudential borrowing framework”. Under the prudential borrowing framework, councils can decide for themselves how much they can afford to borrow without having to seek permission from the government, having regard for the “Prudential Code” provided by the Chartered Institute of Public Finance and Accountancy (CIPFA). Councils must assess the impact of borrowing on the sustainability of their income streams. A number of councils have developed capital infrastructure projects under this scheme.

Programme Procurement Vehicles

Examples of this capital investment type include the Building Schools for the Future (BSFTF) programme and the NHS Lift (NHS Local Improvement Finance Trust) programme in England. The NHS Lift programme is similar to the “Hub” initiative in Scotland.

Although these schemes use the PFI model of contract between the public and private sector, two new features of this programme in schools for instance are the “exemplar designs” element which aims to promote well-designed schools which benefit pupils, staff and the wider community; and “Partnerships for Schools” which aims to improve procurement. Instead of
each school or local authority procuring and delivering their own scheme, the
thinking behind this method of funding capital investment is to streamline
delivery and standardise much of the procurement and commercial
processes.

Building Schools for the Future provided approximately £2.2bn for school
capital investment in England in 2005-06, representing two-fifths of total
school capital spend in England, with the remainder allocated to local
authorities and schools through existing capital programmes.

Existing budgets or tax increases

Other options for funding infrastructure investment include funding capital
investment via the existing Scottish Budget or through increasing taxation on
personal income. As members will be aware, the UK Treasury currently holds
£1.5bn in EYF monies on behalf of the Scottish government, and the
Parliament has the three penny up or down income tax power which on
current projections could generate an additional £1.1bn in 2008-09 (Treasury
2007a).

Selling publicly owned assets

Another option for funding capital may be the selling of publicly owned assets.
For instance, the Howat report states that mutualising Scottish Water could
generate £180m per annum for other priorities. However, the report also
states that sale proceeds from Scottish Water might not be enough to cover
the existing debt of Scottish Water – currently £2.5bn. It is also worth noting
that the Scottish government, in responding to the Howat report, ruled out the
particular recommendation of mutualising Scottish Water. Public assets
owned by the Scottish Executive and listed on the National Asset Register
(Treasury 2007b) amount to £20.843bn (over half of which is accounted for by
roads). Outwith roads, the largest assets listed in the National Asset Register
are NHS Boards (£3.973bn), Scottish Water (£2.848bn), the Scottish Prison
Service (£0.516bn), the Scottish Courts Service (£0.363bn) and Scottish
Enterprise (£0.220bn).

OTHER WORK AND DEVELOPMENTS FOR MEMBERS TO BE AWARE
OF

Previous committee work

Members may be aware that a previous Scottish Parliament Finance
Committee undertook an inquiry into Public Private Partnerships in 2002.
Some of the report focused on the implications of PPPs on workers terms and
conditions. In terms of specific recommendation related to infrastructure
investment, the report recommended:
• Developing and sustaining expertise in the Executive and the public sector more generally on the procurement, lifecycle management, planning and implementation of capital investment;
• Refining and developing option-based appraisal methodologies which provide a robust and transparent framework for assessment of projects and procurement proposals; and
• Liaising with the private and public sectors on procurement and financing methodologies with a view to determining the ongoing capital investment requirements of the public sector.

The Committee called on the Executive to clarify each year what portion of its budget is available for capital investment in major projects for which PPP is a viable option. The report also recommended the Executive indicate if it has identified an appropriate balance between capital investment for public services from public funds and privately funded sources and if so, what that balance is.

In addition, the report recommended that alternative procurement methodologies are examined on an ongoing basis to ensure that the whole range of procurement methods is available to public bodies.

Other key recommendations in the report related to capital investment were as follows:

• The Executive expedites the development of standard PPP contracts to bring down the costs of legal and other advisers involved in contract negotiation, finalisation and enforcement.
• The incorporation of a strategy for community consultation and involvement within PPP contracts to ensure an appropriate degree of local engagement.
• There should be more consistency and transparency in the identification and quantification of risk and the assessment of what risks are actually transferred or created.
• Consideration should be given to the involvement of an independent body in examining proposals for major capital procurement projects, to show added value and to advise on the capital accounting implications of the deal.

Infrastructure Investment Plan

The previous Scottish Executive published its Infrastructure Investment Plan in February 2005, committing the Executive to a “major increase in the level of capital spending”, increasing it by 5% in real terms over the period of the spending period 2005-06 to 2007-08.

This was followed in April 2005, with the establishment by the Minister for Finance and Public Service Reform, of the Infrastructure Investment Group to:

• Ensure delivery of the Scottish Executive’s infrastructure programme
• Maximise Value for Money
Avoid cost and time overruns
Avoid over-ambitious announcements which are not delivered
Build more flexibility for Ministers into spending decision-making

The new Scottish Government’s plans for any changes to the capital investment plans of the previous Executive are expected in the upcoming Spending Review.

New public sector accounting rules

The 2007 UK Budget stated that from 2008 and the new spending review period, government accounts would be prepared in accordance with International Financial Reporting Standards in place of the UK Generally Accepted Accounting Practice. The Budget document states that this change will “bring benefits in consistency and comparability between financial reports in the global economy and…follow private sector best practice” (Treasury 2007a, p154).

The implications of this change are as yet unclear. However, this change may have significance for PFIs in that it could in theory bring billions of pounds of PFI deals on to the public sector balance sheet, that have previously been off-balance sheet.

Critics of PFI have often claimed that the main reason for their existence is that it has allowed the Chancellor to fund much of his capital investment without further increasing taxes or public borrowing. This has enabled Gordon Brown to meet his sustainable investment rule – keeping public debt below 40% of national income. Carl Emmerson of the Institute for Fiscal Studies (IFS) has said (Public Finance, 27 July 2007) that the Treasury is now very close to its sustainable investment borrowing ceiling, which will be breached if the existing off-balance PFI schemes were now placed on-balance sheet. Of the total £53.4bn capital value of UK government PFI schemes declared by the Treasury (Treasury 2007c), £29.1bn (54.5%) is currently off-balance sheet.

Other

Despite PFIs generating heated debate, there has been relatively little by way of systematic research on the merits or otherwise of PFIs on which to come to any conclusions.

Audit Scotland and Scottish Executive

In 2002 Audit Scotland reported on the use of PFI to provide new schools. The study, based on six projects for 65 schools, found that the use of the PFI to provide new schools “has delivered real benefits in terms of project management, risk transfer and financial control”. Furthermore “teachers and
pupils have, in general welcomed the improved accommodation and level of service that have come on line so far”. However, the study also found that it was not possible to “draw overall conclusions on value for money by the comparison of the costs and benefits involved”. On receiving the report from Audit Scotland (2002), the Accounts Commission made a number of recommendations, one of which was that “there is a need for a wider choice of procurement options for future projects including PFI and non-PFI.”

Members may be aware that Audit Scotland is currently undertaking work on the delivery of major capital projects in Scotland. Audit Scotland’s main aim is to “provide a position statement on how recently completed and current major capital projects performed against time, cost and quality targets” (Audit Scotland 2007). This work is something the Committee may wish to keep a watching brief on during the course of the enquiry.

More recently the Scottish Executive published a summary of initial research into the use of PPPs (Scottish Executive 2005a). The report was based on the earliest projects and indicated that “many of the lessons learnt from these projects have already been applied to more recent PPPs”. Bearing this in mind a number of key points emerged and the report highlighted further areas for research. The research found evidence to support the view that “PPP transfers construction risk to the private sector more effectively than historical procurement methods and is likely to deliver value for money where there is strong competition and the projects are large”. However, the research also recommended that further data collection should be undertaken to enable real comparisons to be made about the relative benefits of PPP procurement to non-PPP procurement methods in the areas of competition, timescales, delivery within budget, construction flexibility, risk transfer and perceptions of design quality and innovation.

Recent Parliamentary Question

A recent Parliamentary Question lodged by Jamie Hepburn MSP (S3W-2233) asking the Scottish Executive “what the total cost to the Taxpayer will be of all existing PFI/PPP projects over the course of their contractual life” received the following response:

“Answered by John Swinney (2 August 2007): The total estimated unitary charges for all existing PPP projects over their contractual life is £22.3 billion. This covers 102 PPP projects and spans the years 1999-2000 to 2040-41, a period of 42 years.”

This PQ response prompted a front page Herald article (28 August 2007) entitled “PPP deals cost Scots £22bn” where Allyson Pollock of the Centre for International Public Health Policy at Edinburgh University was quoted as saying:

“This is a phenomenal amount of debt being incurred and stored up, not only for this generation but for future generations too. Others have
noted the ways in which we are mortgaging our children's futures. The high costs of PFI squeezes expenditure on public services spending.”

In response to this article, a letter to the Herald from Gordon Ross of 30 August stated:

“The headline on the article on public private partnerships (The Herald August 28) gives the reader the false impression that all building projects would have been free under the public sector – that all borrowing could have been avoided.

I doubt whether so many projects could have been delivered on time and on budget without PPP, which was introduced because the old public-sector system of procurement and building management failed to meet our needs.”

Borrowing is never costless. An issue for the Committee to consider in this inquiry is whether any additional costs incurred under PFI are outweighed by any benefits of the new ways of allocating operating costs, maintenance costs and the costs of risk.

**Welsh Assembly Committee inquiry**

Members may also be aware that the recently created Finance Committee at the Welsh Assembly has launched an inquiry into Public Private Partnerships with the following possible terms of reference:

“To examine the scope for drawing on private finance for public sector projects with particular reference to:

1. The potential benefits, costs and risks that may be involved;
2. Any policy changes (whether to remove barriers or apply controls) that may be needed to realise the optimum outcome; and
3. Practical guidance to enable the public sector to strike the most advantageous arrangements within the agreed policy framework.”

Members may wish to keep a watching brief on developments in the Welsh Committee's inquiry.
SOURCES


Treasury. (2007b) National Asset Register. London: HM Treasury. Available at:


Ross Burnside
SPICe Research
September 2007

Note: Committee briefing papers are provided by SPICe for the use of Scottish Parliament Committees and clerking staff. They provide focused information or respond to specific questions or areas of interest to committees and are not intended to offer comprehensive coverage of a subject area.
Finance Committee

4th Meeting, 2007 (Session 3), Tuesday 25 September 2007

Note by the clerk on the Convener’s request to attend Smith Institute Seminar

1. The Convener has received an invitation to attend a seminar on “Fair Tax” on 17 October 2007 at 11 Downing Street. The seminar is being run by the Smith Institute, in association with the Institute of Fiscal Studies. The invitation letter is attached as an annexe to this paper.

2. Members are invited to agree that the Convener should attend the seminar on behalf of the Committee.

Allan Campbell
Assistant Clerk to the Committee
5th September 2007
Andrew Welsh MSP
Convenor of the Finance Committee
The Scottish Parliament
Edinburgh EH99 1SP

Dear Mr Welsh

FAIR TAX
SEMINAR 1: WHAT IS A FAIR TAX SYSTEM?

I am writing to invite you to the first in a series of seminars on Fair Tax which the Smith Institute, in association with the Institute of Fiscal Studies, is running at 0800 for 0830hrs on Wednesday 17th October 2007 in 11 Downing Street (with the kind permission of the Chancellor of the Exchequer). The seminar will conclude no later than 1000hrs.

The taxation system is at the heart of the modern state and its relationships with individuals, households and businesses. It is the necessary accompaniment to a government that is engaged in the welfare of its people. It affects the business climate, and the quality of the contribution individuals make to their companies. It increasingly defines national boundaries in a globalised world. The UK tax system has evolved over many generations and it has been used for purposes that go well beyond its historical function of raising revenue. It has been an economic tool to promote efficiency, a political tool to achieve redistribution of income and wealth and a social tool to encourage welfare and development. Today society demands that it delivers fairness among our people and a competitive framework for our businesses.

Real opportunities for informed debate about taxation choices are limited. In principle, the people consent to a given level of taxation at the time of the General Election. In practice, there is little constructive debate even then about the level of taxation and even less about the way in which it is levied. This makes it difficult for any party to claim consensus, either for the taxation system as it stands or for a particular re-shaping of it. What should we tax? What can we tax in the context of today’s global economy, with the changing balance between nations, between capital and labour and between the established and the new? How should we balance our system to meet the wishes and expectations of our people? Should we expect tax to reflect a particular philosophy?

The Smith Institute is an independent think tank, which has been set up to undertake research and education in issues that flow from the changing relationship between social values and economic imperatives

Patron: Baroness Smith of Gilmorehill
Trustees: Lord Haskel of Higher Broughton, Lord Joffe, John Milligan CBE, Paul Myyns, Baroness Ramsay of Carthame,
Baroness Rendell of Barking, Archbishop John Sentamu
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Following opening presentations from and Chris Wales (Managing Director, Lucida plc), and Robert Chote (Director, Institute of Fiscal Studies) the seminar will take the form of a panel discussion. Alongside the opening speakers, the panel will include Francis Chittenden (Professor of Small Business Finance, University of Manchester), Philip Broadley (Group Finance Director, Prudential), Judith Freedman, (Professor of Taxation Law, University of Oxford), and Dr Inwin Stelzer (Senior Research Fellow, The Smith Institute).

If you would like to attend this event, I would be grateful if you would complete and return the attached faxback form as soon as possible and in any case no later than Monday 8th October 2007. Places at this event are strictly limited and will be allocated on a first-come-first-served basis.

Joining instructions, including the documentation required to access Downing Street, will be issued approximately a week before the event to those who have secured a place. If you require any further information at this stage, please contact Paul Hunter on the above number.

With best wishes
yours sincerely

Wilf Stevenson
Director

enc