

The Independent Budget Review
Written Submission by the Scottish Futures Trust

1. Introduction

The Scottish Futures Trust (SFT) is an independent company, established by but operating at arms' length from, the Scottish Government with a responsibility to deliver value for money across all public infrastructure investment.

Our submission to the Review Panel therefore focuses on investment in the infrastructure of Scotland where SFT is the key instrument of change in approach and processes to achieve value. Recently established, we are already working with most public sector bodies across £5.5bn of ongoing public infrastructure projects. The ongoing priority of investing in our nation's infrastructure, along with the need to re-examine and scrutinise activity in key areas including: prioritisation and planning; needs identification; infrastructure funding and financing and collaboration across public sector procurement is set out below.

Our written submission is deliberately brief, and comes from our own independent perspective not that of Government. It focuses on key principles, and we look forward to discussing elements of it with panel members in due course.

2. Importance of Infrastructure Investment to Economic Growth & Jobs

A wide range of academics and commentators have strongly linked a nation's investment in public infrastructure to economic growth over the past 20 years, from the widely referenced Aschauer in 1989 through a discussion piece by the Scottish Executive Economist Group in 2005 to the OECD in 2009. We note that Capital DEL is projected to fall much more sharply over the next three years (12% pa) than Total DEL (3.6% pa).

This perhaps reflects that it is certainly simpler not to start Capital DEL funded investment projects than it is to stop, or even undertake more efficiently, Resource DEL funded ongoing service activities. Our central comment is that favouring ongoing resource funding over capital investment in times of tightening spending, whilst perhaps easier at the time, will be likely to have the effect of both slowing economic recovery and leaving an increased legacy of poor-condition and high-carbon assets to future generations.

Public spending on infrastructure investment (construction) activities will also help to maintain employment within Scotland, principally in private sector businesses, in a sector where the Gross Value Add per employee is significantly higher than the national average. Given the very significant downturn in private sector construction activity, industry commentators have observed that maintaining public investment is needed to retain a regional skilled workforce in the sector. Recent developments in procuring for community benefit could also see a continuation of important training opportunities.

3. Prioritisation & Planning

Infrastructure investment is a long-term business, with significant projects typically taking 5 to in excess of 10 years from inception, through consultation, design, planning, procurement,

construction and into operation. The fundamental characteristics of the assets created should then be in place and operational for 40 to in excess of 100 years. The combination of: reducing capital budgets; the emerging importance of renewable energy; the economic importance of improved communications (transportation and data); and a complex and challenging financing environment mean that prioritisation of investment and planning for its delivery will increasingly have to be undertaken across both portfolios and geographies on a coordinated basis between public bodies. Given the challenges, it may be time to develop a new strategic blueprint for our nation's future infrastructure needs, in partnership with local government and the private sector and coupled with concerted action to improve infrastructure delivery.

There are two closely linked areas of public debate in relation to infrastructure planning that should be had more explicitly:

- **What is the “right” level of infrastructure investment for Scotland?**

If this is the same as the Capital DEL budget (plus Local Authority self financing and user charging), then no public or private sector financing of infrastructure is needed. We can simply “pay as we build”. This point should be explicitly debated, but we note that in recent years of expanding DEL budgets, infrastructure financing on a “pay as you use” model through PFI / PPP / NPD has still been employed to boost investment by circa £500m per annum above Capital DEL budget levels.

- **What of intergenerational equity?**

Is it fundamentally right that infrastructure assets that will be in use for 50 years plus are paid for by this generation as they are built, or future generations as they are used? This is a socioeconomic question outside our remit requiring an examination of historical, current and potential future infrastructure needs and ability to pay, amongst many other factors. However, explicit debate is again important to establishing a proper footing for long-term infrastructure planning.

4. **Needs Identification**

Sitting underneath national level infrastructure planning, huge shift in needs identification to address individual requirements across the public sector is required. Needs identification, asset planning and specification approaches from times of capital growth are not fit for purpose in times of capital scarcity. Taking the schools sector as a single example to highlight a general point: there has been an implicit assumption that better educational outcomes will be delivered from a £25m school than from a £20m school. This is not proven, and even if true makes a value judgement in favour of four “iconic” £25m schools rather than five fit-for-purpose £20m schools. In the future, we will have to accept elements of design standardisation and appropriate space allocations to stretch budgets. We can learn from the North Sea oil platform experience of “design one, build many”. SFT, by targeting achievement of value in a hard headed way, has already driven down budget allocation through this concept challenging need vs. want across sectors.

With careful design by integrated multidisciplinary teams, such an approach will support vital sustainability and carbon reduction targets and the rightful focus on life cycle costs. It will however have to come with an acceptance of less design freedom on individual projects. The

ability to focus on the 20% that should rightfully be different rather than the 80% that could potentially be common should not be seen as a bad thing, and will drive substantial efficiencies across investment programmes.

Following needs identification, a change in the way budgets are allocated could drive increased efficiency and thrift. Current structures and incentives favour the local setting of high budgets at (say) the 90th percentile of probability that outturn will be within the budget. There is no separate central contingency held. This is driven by an “on budget” mindset and inherent risk aversion. The temptation is then to deliver to this budget, rather than to strive to minimise outturn cost. Consideration needs to be given to identifying and holding separately core budgets and contingencies.

5. Infrastructure Funding and Financing

Infrastructure UK has provided a helpful simplification that: “Any infrastructure has to be paid for over time, either by those who use it or by government – this is referred to as **funding**. Meeting the up-front costs of building infrastructure requires **financing**. Financing can be provided either by the private sector or from public sector sources.” In recent years there has been some uninformed commentary that untapped sources of free finance may be available, through the Scottish Futures Trust or otherwise. This is not true, and our simple message is “pay as you build, or pay as you use – but pay you must”.

5.1. Funding Alternatives

Traditionally funding of public infrastructure has been substantially through general taxation, with some existing elements of user charging in for example water, rail and airport related investment. In the future:

- Where there is a clear economic need, and no other available funding source, opportunities could be considered for increased user-charging to fund infrastructure investment. This is particularly relevant in transport where there are live examples of: tolling for estuarial crossings (applied widely around the world), toll roads (eg France, Spain, USA), city based congestion charging (eg London) national level HGV road user charging (eg Germany), national universal road user charging (Netherlands in development). Caution would be required over geographic economic distortions, but the principles have been shown to work. User charging could also be used to directly incentivise carbon reduction, providing a secondary policy benefit;
- Private sector developer funding of infrastructure works required to support specific developments will require reform. The ability of private developers to finance infrastructure up-front has been hit hard by reducing land values and lending market changes. There is an opportunity to develop a public sector bridging finance structure which invests in unlocking infrastructure on a recycling fund basis. It would seek to unlock private investment at a significant multiplier to the public funds invested. This recycling nature and unlocking of private investment means it would represent a high economic-impact use of scarce funds.
- Hypothecation of incremental property based taxes directly to fund unlocking infrastructure investment is the model currently being pursued by the Government and

SFT through Tax Incremental Financing (TIF), in which Scotland is leading the way across the UK. Its application will not be universal, but could be broadened following current pilots into other areas of commercial development (as opposed to residential) led regeneration.

- Infrastructure funding directly from receipts should be increasingly pursued. All public sector assets, including both corporate and land & property holdings should be considered to determine, without short-termism, whether their continued ownership is necessary for the effective and efficient long-term fulfilment of the public sector's core functions.

5.2. Financing Alternatives

If analysis and debate shows that the “right” level of investment is above Capital DEL budgets, there are two broad financing alternatives available to pay up-front for infrastructure and leave a “pay as you use” repayment obligation, namely public borrowing and private finance structures.

Public Borrowing: Firstly, the principle of debt having to be repaid, or interest serviced in perpetuity applies to public borrowing as much as it does to privately raised finance - it is not free. Public borrowing by the Scottish Government is not possible without a change in powers so we do not consider it any further in this paper. Public financing by Local Authorities is possible using their prudential borrowing powers, and access to the UK Government backed Public Works Loan Board (PWLB) for low-cost finance. We have worked with them in the development of Tax Incremental Financing (TIF) and the National Housing Trust (NHT) which apply central support to using these powers in a structured way around the country.

Private Financing: Private financing generally has a higher cost than public borrowing because of the greater risk taken by the lenders. However, if the strategic planning for infrastructure across Scotland identifies that the “right” level of investment is above allocated Capital DEL budgets, then its use is likely to remain necessary. Furthermore, it is the case that across the major economies of Europe, and increasingly the world, private financing of infrastructure is employed by Governments that do have their own public borrowing powers.

There have been mistakes in the past in the implementation of the old models of Private Finance. There is a need to recognise in many cases that the public sector remains the risk taker of last resort in relation to essential public infrastructure that cannot be allowed to fail. SFT has improved value in privately financed infrastructure procurements, and can do so further through:

- Seeking to minimise the weighted average cost of capital (WACC) through the implementation of guarantee structures from Europe that recognise inherent risk taking and seek commensurate debt pricing;
- Making detailed commercial changes, based on extensive market knowledge from the public and private sectors to drive value through maximum competition;
- Extending the use of capped return models which recognise that these essential assets must continue to be financeable, but limit private sector returns in exchange for the

guarantee of financeability. This could be through extended use of a Regulated Asset Base (RAB) financing model as used in Network Rail and UK water industry structures, and on a specific asset basis, for the Northern Ireland gas interconnector.

6. Collaboration and Organisation Structures

From the preceding sections, it is clear that we view increased collaboration between public bodies as necessary to deliver effective asset planning, delivery and management. However, on the ground we have mixed experience of cooperation between both geographically neighbouring and parallel service delivering bodies. The individual accountability, differing legal regimes and governance structures mitigate against collaboration with no clear shared reward. In many instances, the pursuit of the individual optimum is the enemy of the collective good. Strong leadership, combined with instigation through funding incentives to create a shared reward will be required to create the radical change in culture required.

Collaboration on infrastructure planning and procurement need not be seen as a stand-alone activity, or as a follow-on from service redesign. It can be used as a catalyst for service change that can deliver much greater efficiencies. There are examples of co-location driving changed ways of working as teams become more fluid between organisations. The hub programme, led by SFT is actively pursuing these opportunities in community service provision will provide examples of infrastructure planning underpinning service delivery reform.

Collaboration will go so far, but there are situations in which it will not be enough. There is a danger of increased collaboration being used as a fig-leaf to the need for greater organisational or responsibility reform. In this respect, infrastructure investment is no different from service delivery where more radical thinking around de-cluttering and reallocation of responsibilities would be possible, albeit at some short-term cost.

7. Conclusion

The above sections represent a wide ranging response to impending budget cuts and the changed economic environment in respect of infrastructure investment in Scotland. We have alluded to the potential impact of differentially cutting capital investment and have described at a high level some innovative approaches to planning, financing and delivery that could make a difference. We would be happy to expand on any of these, or to provide further evidence on the level of potential savings to be made from specific approaches if the Panel would find these useful to its deliberations or in structuring its report.

Sir Angus Grossart
Chairman

Barry White
Chief Executive
barry.white@scottishfuturestrust.org.uk
0131 510 0800