

Smith Commission - Scottish Futures Trust Submission

Devolved Powers and Infrastructure Investment

1. Introduction

The Scottish Futures Trust was established in 2008, operating at arms' length from the Scottish Government to improve the efficiency and effectiveness of infrastructure investment in Scotland by working collaboratively with public bodies and industry, leading to better value-for-money and ultimately improved public services.

We have restricted our submission to two areas in which we consider that further devolution of powers would be to the advantage of infrastructure investment in Scotland, would be feasible and would not bring any significant disadvantages to Scotland or the UK as a whole. That is not to say that we don't consider any other areas of further devolution would be advantageous, but simply that these two areas are where SFT's particular perspective may be most valuable to the Commission.

2. Principle

Scotland should have the power to be able to determine the right level of infrastructure investment to affordably meet its economic and social objectives, and how this investment is both funded and financed.

Infrastructure investment – investment in the building blocks of the country – affects economic, environmental and social outcomes. It can drive change, as in renewable electricity generation capacity and transmission networks; or support change as in joined up health and social care provision from a new shared building. It can bring economic growth as in the Aberdeen Western Peripheral Route bringing new private development to the Northwest of that city; reduce carbon emissions such as Glasgow City Council's investment in LED street lighting; and improve quality of life for example through increased provision of high-quality and energy efficient affordable housing. Control over the level of this investment, recognising of course that it must remain affordable, is therefore a critical tool to allow different choices across a wide range of policy areas to be made meaningfully.

It is important to recognise the distinction between infrastructure funding and financing: funding is the primary stream of revenues used to pay for an asset; financing, in the form of borrowing or other tools, is used to make cash available when the timing of funding does not match that of costs incurred. Infrastructure funded on a pay-as-you-build basis, as with the current capital budget arrangements, requires no financing. Infrastructure funded on a pay-as-you-use basis requires a form of financing to make funds available to pay for the asset to be built with repayment over time from future revenues.

It is **regulation** across a wide variety of largely economic infrastructure sectors which determine whether it is paid for out of general taxation or by users in a market regime and establishes the framework for asset ownership and public and or private financing. Constraints on **borrowing** powers affect Scotland's ability to finance investment and accelerate economic, environmental and social benefits. It is these two areas which SFT sees as most important for further devolution in respect of infrastructure investment and we comment on each in more detail below.

3. Regulation

Much has been said about energy regulation (head D of Reserved Matters in Schedule 5 of the Scotland Act 1998) which has a significant impact on energy infrastructure as well as consumer protection. The current situation also reserves regulatory powers over telecommunications (C10) and transportation (E). In general these are regulatory powers over utilities and network infrastructure and the services they deliver.

The main drawback of reserved regulation is to prevent Scotland from pursuing different arrangements, for example on the roll-out of high speed broadband and wireless infrastructure, or the approach to infrastructure provision and train operation in the rail industry. Different arrangements may better suit the geography of Scotland or the needs of the Scottish people. Greater coordination across regulatory regimes could increase the potential for the effective implementation of greater cross-network efficiencies. The main advantage of reserved regulation is to create a single market and have common regulation of networks that have significant cross-geography physical interconnections.

The international interconnectedness of both energy and telecommunications networks, and the transportation systems of mainland Europe demonstrate that international standards can overcome issues surrounding the physical connection of separately regulated systems. Weighing against this, separate markets can introduce inefficiencies, although greater coordination across networks if introduced, could mitigate this to some degree.

We would therefore suggest that:

A. Water should retain its separate regulatory framework and in all other areas of the regulation of networks and utilities, Scotland should have significantly enhanced oversight of the regulatory regime. The improved arrangements should provide sufficient powers to reflect Scotland's economic interest and enable greater cross-utility efficiencies to be delivered.

4. Borrowing

The powers for borrowing by the Scottish Ministers established by the Scotland Act 2012 (Section 32) are limited. SFT is interested in infrastructure investment and we therefore restrict our submission to borrowing for investment (or capital expenditure).

The Act reserves control of the amount of borrowing by Scottish Ministers which may be outstanding at any time to a defined value currently set at, and not to be less than, £2.2bn. According to the Scottish Government, HM Treasury has made clear that borrowing in any one year must not exceed 10% of the Scottish Government's capital budget. As this power has yet to come into force, it is not possible to say to what extent it is currently exercised though Scottish Government's draft budget for 2015-16 proposes to borrow up to £304m, the maximum permitted.

This situation restricts Scottish Ministers' ability to utilise borrowing to finance investment which is ultimately funded from future DEL budgets. It restricts one of the financing tools which may be employed to facilitate investment at a chosen level as discussed in Section 2.

Local authorities have substantially different controls over their powers to borrow. These powers are based in general on their own assessment of affordability, or ability to repay, codified through the Prudential Code for Capital Finance in Local Authorities. It appears inequitable that Scottish Government should have a cash value borrowing limit imposed as a reserved matter, whereas local authorities are essentially self-controlling under a codification of ability to repay.

Any limit on Scottish Ministers' borrowing powers does not however remove all options to invest now and take on future repayment obligations. Since devolution in 1999 (and indeed before that time) Scotland has invested using various "revenue funded investment" structures including the Regulated Asset Base arrangements in the rail industry, historically the Private Finance Initiative (PFI) and more recently the £3.5bn Non-Profit Distributing (NPD) programme managed by SFT. Scottish Government figures show that over £6bn of assets have been financed through PFI and NPD contracts and that contracted payments (including capital repayment and service provision) exceed £1bn per annum. These programmes, both historic and ongoing, utilise different financing arrangements but must be afforded from the same ultimate funding streams as Scottish Ministers' borrowing. They are clearly of a substantially greater scale than the capped borrowing powers about to be introduced. It appears inconsistent that borrowing powers, which could provide both flexibility and a lower cost of finance for investment, should have a cash value borrowing limit imposed as a reserved matter.

In that context, Scotland has already demonstrated prudence to determine a level of investment which it can afford to fund. It has committed to a limit on future revenue commitments in respect of capital investment at 5 per cent of its expected future annual DEL budget (Draft Budget 2015-16 Annex A). Within a broader framework for fiscal responsibility, and especially given the position of local authorities, there do not appear to be significant advantages to maintaining an arbitrarily set cash limit on Scottish Ministers' borrowing. The advantages in changing the arrangement would be to give Scotland a wider range of financing choices for its infrastructure investment and potentially improve overall value-for-money.

We would therefore suggest that:

B. In the context of a broader fiscal responsibility framework, the reserved cash limit on Scottish Ministers' annual and total borrowing is removed.

5. Conclusion

We recognise that the limited range of suggestions in our submission relating to infrastructure investment will be considered by the Commission in the light of their significantly wider context. We hope that they will be seen as, on-balance, advantageous and without real practical or legal barriers. We believe they could substantially increase value-for-money for infrastructure investment in Scotland and we would be happy to meet with the Commission to discuss this in more detail should you consider that useful.

Scottish Futures Trust

31 October 2014