FINANCE COMMITTEE

AGENDA

27th Meeting, 2014 (Session 4)

Wednesday 5 November 2014

The Committee will meet at 9.30 am in the Robert Burns Room (CR1).

1. **Further Fiscal Devolution**: The Committee will take evidence from—

   - Professor David Heald, Professor of Accountancy, University of Aberdeen;
   - Professor John Kay, Professor of Economics, London School of Economics;
   - Professor Ronald MacDonald, Professor of Political Economy, University of Glasgow.

2. **Draft Budget Scrutiny 2015-16**: The Committee will take evidence on the Scottish Government's Draft Budget 2015-16 from—

   - Barry White, Chief Executive, and Peter Reekie, Finance Director, Scottish Futures Trust.

3. **Proposed Contingent Liability (in private)**: The Committee will take evidence from—

   - Keith Brown, Minister for Transport and Veterans;
   - Sharon Fairweather, Director of Finance, and Michelle Rennie, Head of Construction, Major Transport Infrastructure Projects, Transport Scotland.

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The papers for this meeting are as follows—

**Agenda Item 1**
Note by the Clerk  
FI/S4/14/27/1

**Agenda Item 2**
Note by the Clerk  
FI/S4/14/27/2

**Agenda Item 3**
PRIVATE PAPER  
FI/S4/14/27/3 (P)
Finance Committee  
27th Meeting, 2013 (Session 4), Wednesday 5 November 2014  
Further Fiscal Devolution

Purpose

1. At its meeting on 1 October 2014, the Committee agreed to undertake an inquiry into further fiscal devolution. The Smith Commission is currently considering what further powers should be devolved to the Scottish Parliament. The purpose of this inquiry is to enable the Committee to contribute to this debate by conducting an inquiry examining the options for the devolution of further financial powers to the Scottish Parliament and the impact of such powers on the block grant.

2. The Committee has issued a call for evidence in relation to the inquiry and has agreed to take evidence at a number of meetings in up to December.

3. At this meeting, the Committee will take evidence from—

   - Professor David Heald, University of Aberdeen;
   - Professor John Kay, London School of Economics; and
   - Professor Ronald MacDonald, University of Glasgow.

4. A written submission has been provided by Professor David Heald and this is attached as an annexe to this note. Written submissions from Professor John Kay and Professor Ronald MacDonald will be circulated to members in advance of the meeting.

   Alan Hunter  
   Assistant Clerk to the Committee
Memorandum by Professor David Heald\(^1\) to the Finance Committee of the Scottish Parliament

**THE FUTURE FINANCING OF THE SCOTTISH PARLIAMENT**

**INTRODUCTION**

1. The Committee’s invitation to submit evidence lists six questions that witnesses should address. Each of these is considered in sections below. As these questions mostly refer to devolved taxes, this ‘Introduction’ places those in the broader political, constitutional and economic context. In June 2014 I provided both written and oral evidence (Heald, 2014b) to the Committee and, except where essential, I will not repeat such material.

2. The Scottish Independence Referendum provides the context for these discussions. Clearly momentum has built up that ‘something dramatic’ must be seen to be done, otherwise disenchantment is a likely response. A political auction has developed as to whose taxation proposals are the most far-reaching. Two cautions are vital: first, that some of the taxation issues are highly technical and poorly understood; and, second, that there are conflicting political objectives – making ‘a New Union’ (Jones, 2014) that will be durable, and demonstrating that nothing short of Independence will work.

3. Several issues are analytically distinct but in practice become interconnected:
   a) **Whether all parts of the United Kingdom have access to the UK resource pool and can make claims based on territorial needs.** As well as the case for decentralisation within a state based on democratic accountability, decentralisation can be argued as a way of reducing the size of the state, by way of tax competition. The standard public finance argument is that redistribution is more effective when undertaken at the highest available level of government, but this runs into difficulty if political preferences about redistribution diverge across the state.
   b) **Which level of government decides the size of the state.**\(^2\) Both sides of the Referendum debate seemed to want to spend more. On the Yes side, this would be financed by the growth and productivity gains it was claimed Independence would bring. On the No side, there was inadequate recognition of the United Kingdom’s existing fiscal deficit and of the present UK Government’s plans to reduce ‘public service spending’ to its lowest level since 1948 (Johnson, 2014b). I have been an advocate of (partial) income tax

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\(^1\) Professor of Accountancy at the University of Aberdeen.

\(^2\) The controversy during the Referendum campaign about the future of the National Health Service (NHS) was confused. Since 2010, there have been strongly positive Barnett formula consequentials from increases in health spending in England, alongside large negative consequentials from other programmes. The Scottish Government has used its expenditure-switching discretion, for example, to mitigate the effects on local government services. Although the Scottish Government exercises legislative and political control over the NHS in Scotland, the overall level of funding for public services in Scotland is primarily determined by UK decisions.
devolution since 1976 (Heald, 1976), but recognise there are limits on the extent to which Scotland could levy personal tax higher than elsewhere in the United Kingdom. Decisions made at Westminster remain profoundly important for Scotland, whether there is sharing of the income tax base or if Scotland’s income tax is standalone. The UK Government will not allow Scotland (or Wales or Northern Ireland) to erode its own tax base and the Treasury will have retaliatory instruments.

c) **Whether the devolved finance system remains expenditure-based or whether there is a significant move to make it more revenue-based.** If a system is expenditure-based, judgements – implicit or explicit – are taken as to the level of spending in each jurisdiction that the collectivity will support. If a system is revenue-based, the level of public spending will depend on the taxable capacity of jurisdictions, with implications for the standards of public services and for internal migration. This is best seen as a spectrum rather a dichotomy. A UK-specific difficulty is that England represents 84% of the UK population and 87% of the GB population. At the first modern census in 1801, England accounted for 74% of the GB population. This dominance of England, likely to increase through time, makes it difficult to design conventional federalism-type financial relationships within the United Kingdom.

d) **Where the fiscal risks sit.** The United Kingdom is of sufficient size that it pools risks more effectively than Scotland could alone, for example in relation to economic activity in, and tax payments from, the oil and financial sectors. On a strict revenue basis for devolution financing, Scotland would be exposed to fiscal risks, while lacking the policy instruments to manage such risks. This is a caution against assuming that devolution is necessarily enhanced by taking on all taxation powers that would have come with Independence.

4. In relation to what a good tax system would look like, there are marked differences between ‘expert’ and ‘popular’ views (Lim *et al*, 2013). These create difficulties for policymakers because popular views place little weight on neutrality (a key concern of reports such as Mirrlees (2011)) and tend to focus on single taxes rather than the effects of the tax system as a whole.

**QUESTION 1: WHAT GENERAL PRINCIPLES SHOULD APPLY TO THE DEVOLUTION OF FURTHER FINANCIAL POWERS TO THE SCOTTISH PARLIAMENT?**

5. There is extensive discussion of relevant criteria in the report of the Expert Group to the Calman Commission (Muscatelli, 2008).

6. **On the issue of devolved taxation**, the particular points I wish to stress for this meeting are:
   a) That the use of devolved tax powers, whether relating to tax rate or tax base, must be credible. Otherwise substantial administrative and compliance costs will be incurred, only
for devolved Scottish taxes to remain identical to UK ones. There were specific reasons\(^3\)
why the tartan tax was never used: the power became effectively unusable when the
Scottish Government took the unannounced decision in 2007 to let the 10-month HMRC
readiness period to lapse (Scotland Office, 2010).

b) That what matters is ‘fiscal accountability at the margin’ (ie the ability to vary taxes) (Blow \textit{et al}, 1996) and not the proportion of expenditure financed by taxes levied in Scotland if those
decisions are not taken by the Scottish Parliament (ie revenues generated in Scotland on
the basis of UK decisions). Raising 54% of revenues (\textit{Guardian}, 2014) does not improve
accountability or enhance discretion if powers to vary do not exist or are not usable.

c) That tax devolution (or the assignment of tax revenues) means that extensive borrowing
powers are required in order to manage year-on-year fluctuations in revenues (see
response to Question 4).

d) That consideration should be given to how powers made available to Scotland might later
be extended to Wales and Northern Ireland, perhaps in modified form. This may not seem
important in Scotland in the aftermath of the Referendum, but the durability of
arrangements is more likely when all three countries have stakes in the arrangements.\(^4\)

e) That while the United Kingdom remains a member of the European Union (EU), there are
legal constraints on within-Member-State variation that affect both VAT and Corporation
Tax.\(^5\)

f) That there should be no detriment to other parts of the United Kingdom. This is easier to
state as a general principle than to operationalise. Examples are tax incentives to induce
re-location of high income individuals over internal borders or to divert air passengers. As
international examples of tax arbitrage demonstrate, the dangers of a ‘race to the bottom’
should not be underestimated. This should rule out devolution of those taxes where the only
motivation for securing them is to reduce/abolish them.

g) That urgent attention is required to local government taxation: there has been no council tax
revaluation since 1991 and this is the seventh year of council tax freeze. Revaluation may
be feared as politically toxic and council tax freezes may be politically popular, but this
combination undermines claims that the Scottish Parliament itself needs more fiscal powers
to be accountable.

\(^3\) So much money came down the Barnett pipeline during the 2000s as consequentials from increased health and education
expenditure in England that all three Devolved Administrations built up End-Year-Flexibility; and Scottish Ministers were
advised that use of the downwards variation of tartan tax would lead to the Treasury challenging the level of the block grant.

\(^4\) Scotland tends to be sufficiently close to the UK average that tax base equalisation is likely to be unnecessary. That is not the
case for Wales and Northern Ireland.

\(^5\) Readings of these constraints differ, but the likelihood that such powers would end up in the European Court of Justice is one of
several reasons for caution.
7. On the issue of assignment of tax revenues:
   h) That the assignment of tax revenues (e.g., the Scottish Parliament receives some percentage of VAT revenues attributed to Scotland) is different from having devolved taxes where the Scottish Parliament has control over the tax rate and (perhaps) tax base. There might be some advantages in terms of political narrative (i.e., countering the view that the block grant is a subsidy from Westminster) but whether there is a genuine stake in VAT revenue growth in Scotland would depend on how the equalisation mechanisms work.

8. On the issue of borrowing:
   i) That greater reliance on devolved taxation and/or assigned revenues inevitably means that the income of the Scottish Parliament will be less predictable: for example, consider how it would have been affected by the 2008 recession and the present tax-poor economic recovery.
   j) That there will have to be ‘internal fiscal rules’ that constrain borrowing to offset cyclical fluctuations and for capital purposes so that the UK Government can meet its international obligations, in particular to the EU.

9. For arrangements to work, in the sense that new powers are usable and that they command consent in Scotland and in other parts of the United Kingdom, there must be full transparency of the funding arrangements (Heald, 2014b).

**Question 2: What further financial powers should be devolved to the Scottish Parliament and why?**

10. My strong preference would have been for the Calman income tax powers contained in the Scotland Act 2012 to be used. This would have been a gradualist step, during which implementation issues could have been resolved. This power is sometimes represented as being ‘much bigger’ than the tartan tax, but that is primarily because the first 10p of yield substitutes for the reduction in UK income tax for Scottish taxpayers. The genuine difference is that the Calman tax applies to the higher and additional rate bands, whereas the tartan tax only applied to the basic rate band.

11. At this juncture, it is useful to introduce some numbers. Scotland’s mid-year 2014 population was 5,327,700, of which 4,416,021 (83%) were 16 or over. The electoral register for the 2014 Referendum contained 4,285,323 voters, estimated to be 97% of those eligible. The latest year for which data are available for Scottish income taxpayers is 2011-12 (HMRC, 2014a), so there is a lag but not one likely to be significant in the present context. There were 2.64 million Scottish income taxpayers paying £11.3 billion total tax. Taxpayers (217,000) with total incomes of £50,000 and above paid £5.018 billion total tax: thus, 8.22% of taxpayers paid 44.41% of total tax. Taxpayers with total incomes of £100,000 and above (42,000) paid £2.548 billion: thus 1.59% of taxpayers paid 22.55% of total tax. This concentration of yield indicates
(a) that declarations on residence in Scotland acquire a significance they have never had before (the maximum additional tax payable/savable under the maximum tartan tax variation was modest)\(^6\); and (b) hints at the constraints on Scottish tax policy. One other source of constraint is that, like the tartan tax, the Calman tax would only apply to non-savings income, excluding savings and dividends because of the administrative complexity involved.

12. The rhetoric that surrounded the Referendum has been taken by many commentators to mean that it constituted a critical juncture in relation to taxation powers. There has been a clamour for full income tax devolution, without fundamental issues being addressed. These are illustrated below, on the assumption that UK income tax would not be levied on Scottish residents:

a) This is likely to cause a flash point at Westminster regarding the role of Scottish MPs in voting for a UK budget containing income tax measures applicable to the residents of England, Wales and Northern Ireland. The implications for government formation have been publicly debated since the Referendum.

b) If income tax were to be fully devolved, that raises the question of whether Capital Gains Tax should also be devolved. These are closely related personal taxes and there are inevitably opportunities to convert income into more lightly taxed capital gains: such conversion would erode the Scottish tax base and benefit the UK tax base.

c) For the reasons discussed under Question 3 below, Corporation Tax is not suitable for devolution. Given that Corporation Tax rates are falling internationally, relative to the taxation of earnings (particularly when National Insurance is added), there are taxation incentives for the self-employed to incorporate, for example, by using personal service companies. These are widespread in the oil services sector, constituting another leakage from the Scottish tax base.

13. Four matters concern me greatly:

a) If the UK Treasury does not have a financial stake in the Scottish income tax base, I would expect both malicious actions (eroding that base through other tax measures) and malign neglect (inadequate attention being paid to interactions with other tax measures and inadequate enforcement from HMRC in the entirely new situation where determination of Scottish residence matters).

b) The potential loss of access to the expertise and economies of scale of HMRC. Over recent years HMRC has received much criticism about its performance, but at least part of its

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\(^6\) At the maximum +3p variation in 2014-15, the maximum annual charge from the (now lapsed) tartan tax would have been £956. Doubling that for a household consisting of two higher rate taxpayers does not reach a total at which actual or declared change of residence from Scotland to other parts of the United Kingdom would have seemed likely.
perceived failures relate to the internationalisation of business and the way in which tax avoidance exploits complexity yet acts as a driver for more complexity.

c) Whereas the Calman Commission took 14 months from appointment to the publication of its final report, the Smith Commission is expected to deliver on a much more complex agenda within 10 weeks in the build-up to a UK General Election campaign.\(^7\)

d) So much effort having gone into devising new financial powers, political parties go into the 2016 Scottish Parliament election promising not to use them.

**QUESTION 3: WHAT FURTHER FINANCIAL POWERS SHOULD NOT BE DEVOLVED TO THE SCOTTISH PARLIAMENT AND WHY?**

14. The criteria for determining which taxes are suitable for devolution were discussed in the Muscatelli (2008) and Calman (2009) Reports. In relation to the large revenue generators:

a) Corporation Tax should not be devolved because, *inter alia:* (i) EU legal cases are likely which will consume time and resources, whatever the outcome; (ii) recent high-profile instances of avoidance show how vulnerable this form of taxation has become despite the OECD’s efforts in its Base Erosion and Profit Shifting project (OECD, 2014); (iii) this would create economic distortions within the United Kingdom; and (iv) the UK Government would use other financial levers against a Scottish Government that reduced its Corporation Tax below the UK level.

b) VAT should not be devolved because, *inter alia:* (i) EU treaties forbid VAT variation within a member state; and (ii) this would create new avoidance and evasion possibilities when the VAT ‘tax gap’ is estimated to be 10.9% in 2012-13 (HMRC, 2014b). It would be possible to fully or partially assign VAT revenues as a substitute for part of the block grant, but that would increase revenue volatility and increase the importance of damping and smoothing mechanisms (see Question 5 below).

c) National Insurance should not be devolved because, *inter alia:* (i) though economists correctly regard this as a second income tax, psychologically the public links it to pensions and other welfare benefits provided at the UK level; (ii) this would lose the pooling benefits over the UK population as a whole; and (iii) this would further complicate policy attempts at the UK level to address the future role of National Insurance.

d) Oil tax revenues should not be devolved because, *inter alia:* (i) of their future volatility in relation to oil prices, production costs and output; and (ii) of these natural resource rents being part of the pool of UK resources.

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\(^7\) The Holtham Commission took 24 months and the Mirrlees Review 31 months.
**Question 4:** To what extent could the Scottish Government be constrained in how it uses new tax powers given the interaction with fiscal decisions at a UK level?

15. Paradoxically, to make devolution finance work better, it is not the Devolved Parliaments/Assemblies/Governments that must change most, but the UK Parliament and Government. UK Budgets are treated as political theatre, where the obligation on the Chancellor of the Exchequer is to pull some rabbit out of the hat in order to catch Opposition parties off guard. The Budgets that attract the most instantaneous praise are often the ones that do the most damage. The predictable result is that UK tax policy has become incoherent (Johnson, 2014a). Reforms that would benefit the UK Parliament itself would be to bring the Budget forward to November and to establish a Tax and Spending Committee which would take on the budget review function that the wide-ranging responsibilities of the Treasury Committee lead it to neglect (Heald, 2014a). Otherwise income tax powers are likely to lead to parity, as any change by a Devolved Administration is vulnerable to countering – whether on thresholds, bands, or rates – by the UK Government. Without appropriate constitutional machinery on intergovernmental financial relations, it would be possible for a UK Government to subvert the financial arrangements, for example, by significantly reducing income tax rates in England while increasing National Insurance and VAT.

16. It is necessary to distinguish between what are (a) constitutional/legal constraints and (b) those that come from the same political parties operating at UK, national and local government levels. Parties have played a highly centralising role, with UK-based parties concerned that actions at sub-national level will be used against them in UK elections. For the ‘New Union’ to work, UK politicians will have to learn to think in constitutional terms (possibly a German-style debt brake: Lodge and Wegrich (2014)), and to develop a harder skin about differential priorities at different tiers of government and jurisdictions.

17. The long-term direction of travel of UK policy has been greater integration of taxes and benefits, yet devolving income tax while holding most social security at the UK level will involve a partial change of direction in the Devolved Administrations. There are some welfare payments where there is a strong case for devolution because of the connections to devolved service functions: housing benefit is an obvious example. There is a public attachment to UK-wide benefit levels (e.g. the state pension) even though it is widely known that its purchasing power varies markedly. The interactions of tax thresholds, tax bands and tax rates, on the one hand, with tax credits and the welfare system (including Universal Credit), on the other, raise issues outside my expertise. What appeared to be the case in the Scottish Referendum is that both sides favoured a more generous social safety net than the UK Government. If that view survives beyond the Referendum campaign, there will be difficult issues of policy design and funding.
QUESTION 5: WHAT ARE THE IMPLICATIONS OF FURTHER FISCAL DEVOLUTION FOR THE BLOCK GRANT?

18. Having a Referendum was bound to put pressure on the Barnett formula in the event of a ‘No’ vote. ‘The Vow’ (Cameron et al, 2014) on the front page of the Daily Record on Tuesday 16th September included the three leaders’ commitment to ‘the continuation of the Barnett allocation of resources’. Although this sounds definitive, the actual meaning is ambiguous. Does it mean one or more of the following:

a) That the Barnett name will be kept;

b) That the population-based adjustment mechanism will continue, whether or not in combination with needs assessment; and/or

c) That Scotland’s per capita public expenditure, which has consistently been above UK=100, will maintain this relative position?8

19. The Barnett formula receives a bad press, some justified but much showing little understanding of how the United Kingdom operates. Indeed, it can be argued that the population-adjustment mechanism of Barnett, and of its Goschen predecessor (Mitchell, 2003), has played a significant role in sustaining the United Kingdom as a multinational state. As well as the advantage to the Treasury (ie not having to become involved in detailed negotiations with the three territories and (now) Devolved Administrations), the formula avoids the Treasury intervening in expenditure priorities. Given the population predominance of England, UK policy is often perceived as English policy and non-English needs would be perceived through those eyes (eg by extending English needs assessment formulae). The existence of the territorial blocks has allowed expenditure-switching, originally by Secretaries of State in the UK Cabinet and later by the elected governments of Scotland, Wales and Northern Ireland. Those arguing for a needs assessment tend to (a) underestimate the complexity and sensitivity of such an exercise,9 and (b) fail to recognise how a built-up calculation might constrain devolved policy-making. The most telling criticisms of the Barnett formula are that (i) there has been a failure by UK Governments to explain the rationale and explore alternatives, and (ii) the 2000s’ period of unprecedented public expenditure growth was not used to recalibrate the formula (Heald and McLeod, 2002). Barnett is now blamed for perceived injustices that have nothing directly to do with Barnett, such as the treatment of the North East of England by within-England distribution formulae.

8 The Treasury has consistently refused to publish spending data on services in England that would be devolved according to each of the three schemes of devolution. The comparative figures which are regularly cited are those for identifiable expenditure, published annually in Public Expenditure: Statistical Analyses (Treasury, 2014) which include much non-devolved expenditure, particularly in relation to social security. The Barnett formula should produce long-term convergence on England = 100 provided that nominal expenditure is increasing. However, this has not happened for a variety of reasons, the most important being the falling relative population of Scotland (see Heald and McLeod, 2002).

9 One of the by-products of the Holtham Commission on devolution finance in Wales was the proposal by two of its three members that the Scotland budget should be cut by £4 billion (Holtham and Miles, 2010). Outside Scotland, it is widely assumed that the Scottish Parliament is over-funded.
20. If the devolution finance system was strictly revenue-based, the Scottish Parliament would have its budget determined by the revenue yield of its own taxes and the revenue yield in Scotland of UK taxes. There would be no grants from the UK Government: there would have to be extensive borrowing powers to cope with volatility, otherwise fiscal decisions would become strongly pro-cyclical. The transfer of tax bases from the UK Parliament to the Scottish Parliament will be accompanied by compensating reductions in the block grant. As with the Calman 10-points income tax transfer, there will be complicated issues of how that is indexed in the future. The view that this makes the block grant less important is mistaken:
a) How this adjustment is done is profoundly important and introduces complexities to a previously simple calculation.
b) Even when there is no explicit needs assessment, the size of the block grant indicates the level of Scottish spending that the UK Government is willing to underwrite.
c) Securing transparency of the calculations acquires more salience because Scottish Ministers have to move tax resolutions to restore the revenue loss, or to exceed or go below that. Under the Calman tax, MSPs would demand assurance that the Treasury has not made changes to the block grant as a consequence of the Scottish income tax being higher or lower than 10p. The same issue will apply in the case of beyond-Calman income tax devolution.

QUESTION 6: WHAT ARE THE IMPLICATIONS OF FURTHER FINANCIAL POWERS FOR THE ROLE OF REVENUE SCOTLAND?

21. I would expect the role of Revenue Scotland to grow through time, but the maintenance of an effective relationship with HMRC in relation to income tax is the foremost organisational issue. Devolved taxes will require a bedding-in period, during which there will be those looking for administrative failures or cases of egregious tax avoidance.

CONCLUSION

22. I understand that the Scottish Parliament wishes to seize the present momentum to achieve an extension of its powers that would either not otherwise be possible or only possible over a long timescale. Nevertheless, I urge the Parliament to tread carefully. Those who wish to maximise devolved taxes should clarify whether they believe:
a) public expenditure in Scotland is too high, too low, or just about right.
b) whether their tax devolution proposals are expected to lead to the overall level of taxation in Scotland being higher, lower, or about the same as in other parts of the United Kingdom.

Aberdeen, 29 October 2014
REFERENCES


I thank the committee for the invitation to give evidence in connection with the devolution of further fiscal powers to the Scottish Parliament, currently being considered by the Smith Commission. My take on the issues at hand are those of a macroeconomist and in that regard I essentially take a top down approach to the issue of fiscal devolution; I daresay a microeconomist would have a different slant on the issues addressed here. In thinking about the questions set by the Finance Committee I was struck by how closely they align with the kind of questions and issues my colleague Prof. Paul Hallwood and I discussed back in 2004 in our paper for the Fraser of Allander series (Hallwood and MacDonald (2004/2005)). At that time there seemed very little appetite, political or academic, for the kind of changes we proposed. Yet what many seem to be proposing today, including my proposals here, are similar to what we proposed then. The proposals outlined here are, of course, not intended to be the last word on these matters but are, rather, intended to promote discussion and debate on this important topic.

1. What general principles should apply to the devolution of further financial powers to the Scottish parliament?

The basic principle in the traditional theory of fiscal devolution (see Hallwood and MacDonald (2004/2005)) is that sub-central government (SCG) should have the ability to provide goods and services that match the particular preferences and circumstances of its constituents. The key presumption is that the provision of public services should be located at the lowest level of government encompassing geographically the relevant costs and benefits. In that way efficiency and economic welfare are increased above a more uniform allocation.

It is generally agreed in the fiscal devolution literature that certain types of public goods and services, whose benefits extend nationwide or because they exhibit important economies of scale, are better provided from the centre. Examples of such would be spending on foreign affairs, defense and interregional infrastructure such as transport and telecommunications. Reserved spending also typically includes elements of social protection such as unemployment benefits and incapacity benefits.

As is well known, the Scottish Parliament (SP) already has a large component of public spending devolved to it (an expenditure budget of £34bn in 2012/13 and Scottish Government and local authority expenditure accounts for 50% of all public spending – Bell and Eisner (2014))). The degree of sub-central government spending as a proportion of total government spending is large by international standards, with only a small number of countries surpassing it. However, on the revenue side of the SP’s balance sheet, we find that the devolution of revenues is considerably behind the devolution of expenditure, creating the well-known fiscal gap of vertical fiscal imbalance (VFI). At present only Council Tax and non-domestic rates are devolved to the SP and these only generate revenue of 8% of total tax revenue. Further tax raising powers will come into effect in April 2015 with the implementation of the Scotland Act 2012. These consist of the devolvement of stamp duty, landfill tax and a new Scottish income tax – Scottish Rate of Income Tax (SIRIT) being introduced.\(^1\)

\(^1\) With this, all UK income tax rates set in Scotland will be reduced by 10p and replaced by SIRIT to be set by the Scottish Government. The Scottish Government is allowed to keep the revenue from the SIRIT but the block grant from the rest of the UK is reduced accordingly. In
With these changes in place, the Scottish Government’s revenue share of total tax revenue rises to 17%, which still leaves a very significant VFI.

How much should be devolved on the revenue side? Clearly reducing the VFI should be a key aim of any further devolution of tax powers, thereby aligning spending with tax revenue and ensuring there is a sufficient revenue base to be consistent with a hard budget constraint (see below), a basic underlying principle in the fiscal devolution literature. However, the minimisation of the VFI is subject to an important constraint and this relates to how much revenue should be placed at the centre for the support of the broader social protection system of risk sharing and revenue pooling. In other words, an exclusive focus on vertical imbalances could result in a horizontal fiscal imbalance (HFI) if fiscal transfers from the centre are inadequate for the equalisation of resources based on ‘needs’ at the SCG. Armstrong and Ebell (2014) indicate that the average central government revenue across OECD countries was 32% of GDP in 2012, which would amount to a payment of roughly £40bn if Scotland were to contribute this amount. However, the figure falls quite dramatically to around 21% of GDP for countries with a more federal structure which seems to be the political direction of travel with respect to the future structure of the UK.

In thinking about the devolution of fiscal powers my past work on this topic suggests a further two important principles are worth mentioning in this regard. The first relates to the kind of budget constraint faced by the Scottish Parliament (SP) - soft or hard (see Hallwood and MacDonald (2004/5 and 2009)). Since its inception, the large VFI of the SP means that it effectively faces a soft budget constraint and therefore does not need to consider all of the political consequences of its actions. The second important principle is the marginal principle where from a starting point of some form of fiscal balance, any decision to raise spending by £1 would require a corresponding £1 rise in taxes (Hallwood and MacDonald (2004/2005)).

The large literature on the financing of sub-central government establishes the principles that for fiscal efficiency – in both spending and taxing, as well as in accountability to the voters - the budget constraint under which political decision-makers operate should be hard. This means that decisions taken by the Scottish Parliament have real costs: that increased spending means that taxes – the burden on the voters - will have to go up to finance it. In general, voters and citizens at the sub-central level have to understand that the public spending they vote for has real costs to them. With a soft budget constraint, public sector decision-makers do not have to make hard choices, trading off greater public spending with greater tax burdens on the population that gets to enjoy that greater level of public spending.

The four main principles of a hard budget constraint (HBC) on SCG – such as the Scottish Parliament are (see Hallwood and MacDonald (2014)) that:

i) A HBC aligns policies offered by SCG with what the voters at that level are willing to pay for. This is not inconsistent with equalization payments between regions of a country, but these would normally be expected to flow to low income per head regions.

ii) A HBC creates incentive alignment between SCG and central government (CG) – the former does not spend funds allocated to it wastefully. This is a misuse of funds, or moral hazard, issue.

iii) A HBC is time consistent, in the sense that SCG should not expect to be bailed out by CG if it mismanages the level or allocation of its’ spending.

the SRIT set up the Scottish Government has no authority to vary thresholds or rates individually and it therefore amounts to a flat rate tax (Bell and Eisner (2014)) so leaving income distribution as a reserved issue.
iv) A HBC should prevent adverse selection by voters at the SCG level when voting for their SCG. That is, the political parties should be unable to make promises that they know, or, should know, are un-financeable in the long-run.

In the Scottish context, and to the extent that this could practically be achieved in the context of the UK framework, the government budget constraint could be made hard by simply fully devolving all feasible taxes and then ruling out any bloc grant component from the centre, with the latter being replaced by borrowing powers at market interest rates. In practice, however, such a system of full fiscal autonomy could only really be achieved with independence. As Carney (2014) notes, for example, it is not a system which is consistent with a monetary union with the rest of the UK nor is it consistent with a system of revenue pooling / risk sharing that is currently provided in a wider UK context with the existing social protection system in which a significant contribution from the periphery to the centre has to be made. How then can a HBC be created for the SP given the desire to be part of a unified Social protection system and the need for stability in the revenue flow? The elements of how this can be achieved are outlined in Hallwood and MacDonald (2014):

i) Any extra taxes raised in Scotland are not shared with Westminster, or, they are not so during some extended period of non-adjustment. If this were not the case, the incentive to use tax policy to increase the Scottish tax base (size of the economy) is diluted. For example, if Scottish taxes were set to finance 40-percent of the Scottish Parliament’s spending, for every extra £1 of Scottish tax revenue 60-pence would be sent to Westminster.

ii) Likewise, if the Scottish Parliament’s tax policy led to a smaller tax base (a shrinking economy), it should have to live with that during an extended period of non-adjustment. If it were otherwise, a moral hazard would be imposed on the rUK, namely, that Scottish tax policy is a riskless exercise for MSPs and voters.

iii) Borrowing by the Scottish government would either be restricted in certain ways by, say, a stability pact or it could be purely market determined. This is considered in more detail below.

I have taken questions 2 and 3 together.

2. What further financial powers should be devolved to the Scottish Parliament and why?

3. What further financial powers should not be devolved to the Scottish Parliament and why?

The basic principle here should be one in which the balance between having a hard budget constraint that cannot be so hard that it compromises the risk sharing /resource pooling aspects of the UK. As noted above, an alternative way to think of this is how to ensure that neither the vertical nor the horizontal fiscal positions become badly unbalanced. Clearly this is not a straightforward task! In thinking about these questions it is important to make the distinction between the devolution of financial powers and their assignment, since a considerable component of the economic benefits can be achieved by the assignment of tax revenues.

Should further spending be devolved? The biggest area of expenditure that has not so far been devolved, but features in the current fiscal debate on the devolution of
further powers is welfare spending, with all political parties, apart from the
Conservatives, suggesting more latitude in this direction. However, as we have noted
the Social Protection budget is central, if not indeed synonymous, with the risk
sharing/resource pooling mechanism and attempts to devolve a significant
component of welfare would lead to an unpacking of this system. Furthermore, and
other things being equal, further devolution on the spending side would of course
increase the overall fiscal gap/VFI.

However, and as noted above, an important underlying principle of the fiscal
devolution debate is the principle that sub-central levels of government are better
able to reflect the preferences of the sub levels of the electorate and in that regard
Scotland already has a distinct policy with regards to, for example, elderly care and
so it would seem to be natural to devolve the Attendance Allowance component of
the welfare budget. Clearly, similar cases could be made for the devolution of other
items. Since the Scottish Government has responsibility for skill and training policy,
the devolution of the Work Programme would seem to be a further natural
component worthy of devolution. Although there may be practical difficulties, housing
benefit would seem another candidate for devolution since it is linked to other areas
already devolved.

Turning now to the taxes to devolve/assign. In the run up to the referendum the
Liberal Democrats, the Conservatives and the Scottish Greens argued for the full
devolution of income tax where by ‘full’ they mean both the rates and the thresholds
(base) be devolved. The focus on income tax as the key tax to devolve is, as Bell and
Eisner (2014) note, that it has a broad and stable base, it is highly visible to the
electorate, and its burden falls largely on those who benefit from the devolved
service. In terms of the hard budget constraint mentioned earlier I have sympathy for
proposals that involve the full devolution of income tax. However, as has become
evident since the independence referendum, however, there is an important political
economy, or perhaps more correctly realpolitik dimension to the full devolution of
income tax, and that is the English votes for English laws (EVEL) argument.

The full devolution of income tax would presumably bolster the case for EVEL that
could lead to Scottish MP’s being excluded from voting on income tax. But because
the UK is such an asymmetrical union, with England comprising 85% of the union, as
Armstrong and Ebell (2014) note any decisions made in England on income tax
would ‘de facto set macroeconomic policy agenda for the whole UK. And since an
English government may not be the same as the UK government, this violates the
principles of fairness and accountability’. It is therefore inappropriate to think of
devolution of income tax in isolation, especially if the end result of the total devolution
of income tax was that the Scottish electorate had no say in the determination of UK
macroeconomic policy.

The next largest tax, in terms of revenue generated, is VAT. European legislation
means that VAT is effectively a reserved tax and therefore cannot be devolved.
However, there would be nothing to stop a proportion of this tax being assigned to
the SG which would be consistent with the HBC concept as it would still give the SG
incentives to grow the economy, although it would also of course introduce downside
risks.

National Insurance contributions were originally seen as direct payments for the
funding of the welfare system and with that interpretation, and if there is a direct link,
given what we have said above, they probably should not be devolved. However,
with the passing of time NI are regarded simply as another form of taxation and the
link with the direct funding of the welfare system is now unclear and I would therefore not rule out devolving a proportion of NI taxes.

I do not favour the devolution of a geographic share of North Sea Oil (NSO) revenues. As is well-known oil revenues, like all commodity revenues, are very volatile and this has been evidenced by the sharp fall in the price of oil over the last few weeks. The devolution of oil revenues would introduce an important potential for asymmetric shocks within the UK and this goes against the risk sharing / revenue pooling concept. I see the block grant element in any devolution settlement as effectively returning oil revenues to the SP in a smoothed form.

Although corporation tax has been mooted as a potential tax to devolve, it seems there are a number of factors that would weigh against this. First, European legislation is moving in the direction of abolishing loopholes whereby countries such as Ireland have had dramatically different rates of corporation tax to the average. Furthermore, corporation tax competition seems to work best in truly federal systems, such as the United States, and it is unclear that it would work in the kind of asymmetric union that is the UK. I do not therefore propose the devolution of corporation tax although there would be nothing to rule out the assignment of a proportion of this tax in the VFI / HFI trade off.

The fiscal devolution literature indicates that customs and excise duties should not be devolved since they can create distortions in a single market system, effects which are likely to outweigh a differential health policy with respect to alcohol, especially since such taxes currently operate as taxes on production rather than consumption. These taxes could though be assigned.

The remaining smaller taxes that I would recommend devolving are: air passenger duty, capital gains tax and inheritance tax.

I now attempt to sketch what a devolved settlement may look like given our discussions above. The Scottish Government’s 2013 GERS report shows that in 2012/2013 the total revenue generated in Scotland is £53,147 million, which includes a geographic share of NSO. If 20% of Scotland’s GDP were to be ring fenced to the centre for Social Protection, as mentioned above, this would leave £29,147mn (£53,147mn-£24,000mn) of revenue that could be devolved or assigned to the SP. The following table attempts to show how such revenue could be devolved or assigned to the Scottish Parliament, given the existing taxes that are devolved and those devolved in the Scotland Act. This total from the table is a figure of £28,443mn which roughly matches the available funds and also almost closes the VFI to zero (clearly this number could easily be tweaked to the maximum of £29,147mn, although the lower number allows for some upward devolution in the spending – welfare - side of the balance sheet) whilst still retaining a horizontal balance.
Table 1. Potentially devolved and assigned revenues for the Scottish Parliament.

<table>
<thead>
<tr>
<th></th>
<th>Income</th>
<th>VAT</th>
<th>NI</th>
<th>Corp</th>
<th>FuelD</th>
<th>Tob</th>
<th>AlD</th>
<th>Air</th>
<th>Ctax</th>
<th>NDR</th>
<th>Stamp</th>
<th>Land</th>
<th>CIT</th>
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<tbody>
<tr>
<td>Total</td>
<td>10,865</td>
<td>9,347</td>
<td>8,521</td>
<td>2,872</td>
<td>10,258</td>
<td>980</td>
<td>2,006</td>
<td>1,981</td>
<td>472</td>
<td>100</td>
<td>435</td>
<td></td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>5,432.5</td>
<td>1,874</td>
<td>234</td>
<td>2,006</td>
<td>1,981</td>
<td>472</td>
<td>100</td>
<td>435</td>
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<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>A</td>
<td>5,432.5</td>
<td>4,674</td>
<td>1,436</td>
<td>2,258</td>
<td>1,128</td>
<td>980</td>
<td>234</td>
<td>2,006</td>
<td>1,981</td>
<td>472</td>
<td>100</td>
<td>435</td>
<td></td>
</tr>
</tbody>
</table>

Where: D and A denote devolved and assigned taxes, respectively, with the proportions implicitly given; Income = Income tax; VAT = Value Added Tax; NI = National Insurance; Corp = Corporation tax; FuelD = Fuel duty; Tob = Tobacco duties; AlD = Alcohol duties; Air = Air passenger duty insurance tax; Ctax = Council tax; NDR = Non-domestic rates; Stamp = stamp duties; Land = Landfill tax; CIT = Capital gains and Inheritance tax. All figures £million.

Source: Government Expenditure and Revenue, Scotland 2012-13

4. To what extent could the Scottish Government be constrained in how it uses new tax powers given the interaction with fiscal decisions at a UK level?

In the proposals here, and in other recent proposals, macroeconomic stabilisation of the total UK economy, using a monetary fiscal mix, would remain a reserved matter. For example, the Scottish Government has made clear in its submission to the Smith Commission that it would use ‘greater tax, spending and borrowing powers within a sustainable overall fiscal envelope guaranteed by clear rules and procedures to ensure affordability’. Such rules would likely, for example, preclude the direct use of fiscal policy for countercyclical reasons, since in a monetary union (with a fixed exchange rate and single interest rate) some of a fiscal expansion in Scotland would spillover into the rest of the UK which would be unwelcome in terms of overall macro policy making.

Given that the devolution and assignment of tax revenues introduces an extra degree of revenue risk into the calculus of the Scottish Government, which of course is partly the reason for having fiscal devolution in the first place, further borrowing powers would be needed and to be consistent with the notion of a hard budget constraint these should be market determined. This is discussed further below.

In my proposals above, since oil revenues would not be devolved or assigned this would remove the potential for Scotland to be hit by asymmetric shocks relative to the rest of the UK; in a sense, Westminster acts as an oil fund, smoothing revenue changes through a bloc grant. Absent asymmetric shocks, and given the synchronous nature of the business cycle between Scotland and rUK (see Hallwood and MacDonald (2004/2005)) we see no role for a separate macroeconomic stabilization role in Scotland.

5. What are the implications of further fiscal devolution for the block grant?

I see a block grant component continuing to play an important role in the financing of Scottish spending due to the provision of a UK wide social protection system. Indeed, there seems to be a consensus amongst all the political parties that the Barnett form of block grant will remain, at least in the short term, with a perhaps revised needs based block grant replacing Barnett in the medium to longer run.

The Scotland act will lead to a reduction in the block grant, on a one-off basis for the landfill tax and stamp duty land tax, and on an on-going basis through the Block...
Grant Adjustment for income tax, using the Indexed Deduction method. If the block grant did fall as a result of the proposed changes, or if the Barnett block grant was replaced, then as Hallwood and MacDonald (2014) argue it is crucially important that block grants from Westminster should not be elastic in the sense that if the Scottish Parliament cannot finance its chosen spending level out of the existing block grant and own-sourced taxes, the block grant is not automatically or quickly increased.

In this regard, the Holtham Commission, for example, recommended a 12 to 15 year ‘waiting period’ with respect to the Welsh Assembly and Government. A non-elastic block grant amounts to a ‘no bailout clause’ (it is time consistent). The advantages of this are (Hallwood and MacDonald (2014)):

a) SCG spending decisions have to look to whether they are financeable during this extended period of time.
b) As there is a risk in adverse circumstances that taxes at the SCG level will have to go up to maintain chosen expenditure levels, the Scottish Parliament is forced to balance the benefits of its spending choices with the cost to Scottish taxpayers. This principle is consistent with risk sharing in a ‘welfare’ union. But a ‘sharing union’ is not the same thing as an ‘unlimited pocket money system’ that would impose no costs at the sub-central level, simply transferring them to the rUK.

It is crucially important in designing any block grant system that the SP should be able to keep any extra revenue it generates through the devolution or assignment of taxes and equally it should face the risk of inappropriate spending decisions and this is consistent with the so called Holtham interlude. An alternative, and perhaps much simpler way of designing a block grant which captures these costs and benefits and also provides a no bail out clause would be what could be termed an ‘automatic pilot’ block grant. The idea here would be at the beginning of a new devolution settlement a new block grant would be introduced. This would not be tied to spending in rUK but would change by a simple formula such as the nominal rate of growth of the UK economy. This would have two components – the current rate of UK inflation and a ‘real component’ which could be the average rate of UK growth over the business cycle.

The operation of the system could be revisited, say, every 5 years to ensure that unforeseen anomalies did not arise. The starting point size of the block grant is likely to be contentious since so called secessionist arguments for the further devolution of fiscal powers (see Hallwood and MacDonald (2009) and others) would suggest that this should be generous, whereas those that would emphasize that the SG should accept its fair share of the UK’s deficit reduction policy would presumably expect any new block grant settlement to be more modest, especially if a new fiscal settlement gave SG significant new borrowing powers.

With a revised devolution system in place where a substantial amount of revenue had been directly ceded to the SP to narrow the VFI – either through direct assignment or devolution – the ability of the SP to borrow freely for both current and capital spending becomes important. The only way this could be done, and be consistent with the moral hazard / no bail out issues discussed here is if the borrowing was undertaken at market rates of interest. Doubtless the rates charged by financial markets would be above those on Treasury bonds, since the Scottish Government would not have an established record of borrowing in financial markets, and the spread may even be an increasing function of the amount borrowed. This ‘Treasury spread’ would of course in itself be a disciplining measures since it would have to be paid for ultimately from taxation in Scotland and would be consistent with the no-bail out clause discussed above.
6. What are the implications of further financial powers for the role of Revenue Scotland?

I would imagine the role of Revenue Scotland would increase with the further devolution/assignment of powers, although this would depend on whether Revenue Scotland would provide a more efficient outcome than retaining HMT.

References


Devolution of further fiscal powers – an inquiry
Submission from Professor John Kay

1. The starting point of discussion should be ‘what would the Scottish Government and Parliament want to do that it is now unable to do?’ which is a different question from ‘what additional powers should the Scottish Government and Parliament have?’ A considered answer to the second question must surely be dependent on the answer to the first, and the additional powers that Scotland should have are those relevant to the achievement of the things that Scotland has been frustrated from doing between 1999 and the present.

2. Most of the things Scotland has been frustrated from doing seem to be things that Scotland lacks the money to do rather than the things Scotland lacks the power to do. Certainly that is true of the Scottish Government’s pre-referendum White Paper and what I can gather of the stances of other parties.

3. But it is naive to think that post-referendum negotiations are going to change that reality. The notion that additional tax revenues will come from some place other than higher taxes is a fantasy mainly espoused by some US Republicans. Worse, whatever commitments may appear to have been made in the last days of the referendum campaign, the Barnett Formula is now inevitably under pressure. In its design, it was intended to produce convergence between Scottish and English per capita expenditures in the long run. It has not done so. This seems to be because the UK Treasury, which has considerable flexibility in operating the formula, has mostly chosen to do so on a basis favourable to Scotland. In effect, a tacit compromise has allowed it to be ‘Scotland’s oil’ without actually openly acknowledgement.

4. But that position will be difficult to sustain going forward. The mechanics of all this, which have been hidden in decent obscurity since 1978, will now inevitably be
the subject of public discussion, and if Scotland does have significantly greater tax raising powers of its own then the operation of the formula will be more obviously a subsidy to Scotland than at present. This will inevitably be the subject of scrutiny, criticism and resentment from English regions and cities, and from Wales and Northern Ireland - which can lay some claim, which Scotland can not, to subsidy on a ‘needs’ basis.

5. Within a fiscal union, there is a trade-off between giving the local government an incentive to promote economic growth and achieving needs based transfers between regions - the same trade-off that exists in designing a benefit system for households. Because Scotland can justify little if any needs based transfer - so that any future shortfall in the Scottish tax base would, in large measure, be Scotland’s own fault, this consideration points towards more rather than less decentralisation of tax raising power.

6. There will, however, be some desire to appease Scottish opinion in the face of a 45% vote for independence and - as in Quebec - some willingness to pay to hold the country together. But I would not count on much generosity from this source. On balance, the likely overall fiscal outlook looking forward will probably be worse not better, as a result of the events of the last few months.

7. The referendum campaign confirmed that the centre of political gravity in Scotland is somewhat to the left of that in England, and that there is therefore potential support for policies that would involve both higher tax and spending levels in Scotland. It is important to note that income tax, national insurance and VAT are the major revenue raisers, and social security, health and education are the principal components of expenditure. Discussion should therefore focus principally on these.
The treatment of smaller revenue and expenditure items will largely follow from a decision about how these major areas are resolved.

8. Devolution of VAT is almost certainly excluded by EU obligations, although it would certainly be possible to apportion VAT revenues based on statistical analysis of VATable consumption in Scotland relative to the UK as a whole. This would have the appearance (but little more) of the Scottish government raising a larger proportion of its own revenue, and would give the Scottish Government a share of any differential growth (positive or negative) in Scotland. But this is largely a cosmetic change.

9. As the impact of VAT apportionment illustrates clearly, there are two measures of fiscal responsibility - the average and the marginal. The first measures the proportion of its government spending which a government raises, and the second the issue of what proportion of any additional spend must be raised locally. The answer to these questions incorporated in the 1997 devolution settlement was extreme - almost none of overall expenditure was raised locally, but a full 100% of additional spending had to be.

10. This observation draws attention to a salient if little commented on fact in the present debate - that since 1999 the Scottish Government and Parliament have had the power to vary the level of taxation and have not only not used it but do not appear to have given serious consideration to using it. If Scottish opinion really did favour a higher tax/higher spending environment, then successive Scottish governments have notably refrained from putting that option to the Scottish people. Perhaps it takes some time for a devolved government to learn how to adopt autonomous fiscal policy. Perhaps it is just easier to blame any shortage of funds in Scotland for desirable public projects on the parsimony of Westminster.
11. The point is important because if Scotland did aim for a tax/spending balance different from the UK as a whole, income tax is the most obvious vehicle for exercising that choice, and the three point differential permitted by the current legislation is at or close to the limits of what it would be reasonable to risk implementing before seeing the impact in practice on choices of location within what will remain a country with high labour mobility. The practical implication is that (as perhaps Calman envisaged) further decentralisation of income tax is primarily a trigger for utilising the already decentralised authority over income tax.

12. Would Scotland want control over the structure (as well as the rates) of income tax? Obviously it would make sense initially to take over the existing UK income tax code in its entirety, but over time this could be changed. Again, it raises the question of what a Scottish Parliament and Government would actually want to do with additional powers as preliminary to asking what additional powers it should have.

13. The other substantial tax is national insurance contributions. Plainly the issue here is closely bound up with the future of the benefits system. Two questions arise:

i. It is possible to 'unpick' the benefit system, devoting particular aspects of it, without devolving the whole? If, as I am inclined to think, devolving aspects of it might be possible, but would be undesirable, because of the compelling arguments for looking at the benefit system as a whole. (There are also arguments, but less forceful, that income tax and benefit policy should be considered together - certainly they cannot simply be determined in isolation from each other).

ii. And if devolving benefits is an all-or-nothing choice, is Scotland prepared for what 'all' would involve? In my view, resolving these issues (particularly in relation to
pensions) is one of the most difficult - perhaps the most difficult - economic issues which negotiations would have had to resolve if the independence vote had been carried.
Finance Committee
27th Meeting, 2013 (Session 4), Wednesday 5 November 2014
Draft Budget 2015-16

Purpose

1. The purpose of this paper is to provide background information for the oral evidence session with the Scottish Futures Trust (SFT). A submission from the SFT is attached.

Scottish Futures Trust

2. The SFT is an independent company, established by the Scottish Government (SG) in 2008, and is responsible for delivering value for money across all public sector infrastructure investment. It operates at arm’s length from the SG but works closely with the public sector to seek and deliver improved value for taxpayers.

3. In the draft budget for 2014-15, the SG states that “SFT has reported the delivery of £139.7 million of net future benefits and savings during 2013-14, as set out in their Statement of Benefits 2013-14. SFT has now reported a total of £640 million of savings and benefits.”

4. The Scottish Government (SG), in its draft budget 2014-15 states that its tax, spending and borrowing plans are focused on—

   - making Scotland a more prosperous country
   - tackling inequality; and
   - protecting and reforming public services.

Non-profit Distributing (NPD) Model

5. Draft Budget 2014-15 states that: “Significant progress has also been made with the current £2.5 billion NPD pipeline, with projects worth almost £750 million currently in construction, including Inverness College (£45m), City of Glasgow College (£193m), Ayrshire College’s Kilmarnock Campus (£48.5m) and M8, M73, M74 Motorway Improvements (£310m).” In the letter to the Cabinet Secretary for Finance, Employment and Sustainable Growth which is annexed to the SFT’s submission, the SFT provides a summary table of the investment profile as follows—

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### Table

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<tr>
<th></th>
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<tbody>
<tr>
<td>2013-2014</td>
<td>185</td>
<td>156</td>
<td>177</td>
</tr>
<tr>
<td>2014-2015</td>
<td>809</td>
<td>757</td>
<td>614</td>
</tr>
<tr>
<td>2015-2016</td>
<td>932</td>
<td>865</td>
<td>954</td>
</tr>
<tr>
<td>Total 2013-2016</td>
<td>1,926</td>
<td>1,778</td>
<td>1,745</td>
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</table>

6. In its letter to the Cabinet Secretary, the SFT states—

“The three-year total investment profile is projected by procuring bodies to be higher than the adjusted estimate from last year. However, in SFT’s estimation it could out-turn lower given historic precedents of the potential for time scales to move as these complex projects are finalised to deliver the best possible long-term value and user experiences over their life cycle.”

7. In its report on Draft Budget 2014-15, the Committee commented on “the significant overestimation of the delivery of NPD projects in specific years” and asked that “the Government reviews the process for formulating these estimates.” In response the Government stated that the “cost of investments is refined in the process of scoping the project and developing the business case” and that “on balance, the Government has operated on the basis that it would be more useful to provide the Parliament and the construction industry with indications at an earlier stage.”

8. The SFT sets out its approach to how its presses “for pace” by actions including—

“issuing further standardised commercial documentation to avoid protracted negotiation, revising payment terms for the (largely SME) design teams involved in hub project development to allow them to accelerate resource input, agreeing inflation allowances with Local Authorities to incentivise timely delivery when realistic programmes have been agreed and managing the majority of financing competitions centrally to speed decision making.”

9. In relation to how experience to date is being used in planning for future projects, the SFT’s letter states that—

“The £1bn programme extension will benefit from the lessons learned in delivering the current projects and we are currently putting together detailed implementation plans.”

### Borrowing

10. In Draft Budget 2015-16, the Government states that it plans “to use our new capital borrowing powers in order to maximise our infrastructure investment in 2015-

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and that “In light of our commitment to investment in long-term growth and the vital stage in the recovery that we have reached, we will use the capital borrowing powers provided under the Scotland Act 2012 to borrow up to £304 million in 2015-16, the maximum permitted.”

11. In terms of the options for borrowing, Draft Budget 2015-16 sets out the three options that are available for borrowing: the National Loans Fund, from banks on commercial terms or by issuing bonds. The Government states that “We are evaluating these options for borrowing and will in due course take a decision on which method or methods to use based on the prevailing economic conditions.”

12. In his letter to the Committee of 13 December 2013 in relation to changes to the budget process, the Cabinet Secretary proposed the Draft Budget would contain information about the “purpose and rationale of borrowing” and an annual update on the costs of repayment and the Scottish cash reserve.” The Committee agreed to this proposal which is now reflected in the terms of the Written Agreement. However, it is not clear from Draft Budget 2015-16 how the borrowing will be used to support particular areas of investment.

13. The Committee will be able to explore this further with the Scottish Government at a future meeting. However, given the SFT’s role in delivering value for money across all public sector infrastructure investment, the Committee may wish to take the opportunity to ask the SFT about what discussions it has had with the Government about the planned use of capital borrowing. In particular the Committee may wish to explore the timing for use of the funds acquired through borrowing, given that costs in relation to repayment will begin accrue from the date of borrowing.

Conclusion

14. The Committee is invited to consider this information and the attached paper in its oral evidence session with the SFT.

Catherine Fergusson
Senior Assistant Clerk to the Committee

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1. Introduction
The budgetary and wider economic, social and environmental benefits of SFT’s work on additional investment now spans housing, health, social care, education, transport and enterprise. SFT programmes are set to deliver £671m of additional investment in 2014-15 with over £1bn to follow in 2015-16. They currently support approximately 6,700 jobs and are accelerating delivery of assets which contribute significantly to stronger economic growth and public services reform. This additional investment comes mainly from the Non-Profit Distributing (NPD), Investment for Growth (TIF and GAM) and National Housing Trust (NHT) programmes. These are each outlined for the Committee below.

2. NPD
The £2.5bn NPD infrastructure investment programme remains one of the largest of its type in Europe, delivering additional investment over and above traditional capital budgets, which remain constrained across the UK. Given that constraint and limited borrowing powers the availability of NPD funding to vital projects, such as the Aberdeen Western Peripheral Route (AWPR), brings forward construction by many years and acts as a catalyst to private investment. In the case of the AWPR commercial development is already taking place along the proposed line of the road. More widely the NPD programme currently supports around 6,000 jobs.

In April a £1bn extension to the programme was announced allowing a pipeline of additional investment, supporting thousands of jobs, through to 2020. The indicative allocation of the £1bn is: £400m for health; £330m for schools; £140m for colleges; £60m for justice; and £70m for the innovative development of projects to meet digital and low carbon policy priorities.

Across the NPD programme more than £800m is already in construction with a further £900m of contracts to be signed over the next 8 months. SFT’s letter to John Swinney of 7 October (Annex 1) provides an update on that programme.

3. Housing
SFT has pioneered additional investment in affordable housing. This is an important sector both for individual occupiers, who are typically around median income working households with a very high proportion of their income being spent on renting in the private sector, and for the economy as a whole.

SFT developed and is now delivering additional investment in the affordable rent housing sector through the National Housing Trust (NHT) initiative which provides mid-market rent accommodation. The original NHT structure is based on a joint venture between SFT, private developers and local authorities, allowing affordable housing to be developed without Scottish Government grant subsidy. This is such a success that it is currently in its fourth round of procurement with contracts signed for the delivery of 1,275 units and progress summarised as follows:
Overall demand for NHT homes has exceeded supply and has been particularly strong in the areas of Aberdeen, Inverness and Edinburgh. A targeted procurement for the City of Edinburgh Council was launched in September 2014 providing the capacity to develop a further 500 homes.

The newer NHT local authority variant utilises a Council led arms’ length delivery vehicle in partnership with SFT. This variant was developed by SFT in conjunction with Stirling Council and has now been adopted by Scottish Borders Council. Together the two current local authority variants are expected to deliver around 375 units into the mid-market rent sector by 2016-17. Aberdeenshire Council is currently going through its approval process for the variant with a potential pipeline of around 160 units.

4. Investment for Growth

SFT developed Tax Incremental Financing (TIF) in Scotland from an arrangement widely used in the USA. We are currently working with 5 local authorities (Argyll and Bute, Falkirk, Fife, Glasgow and North Lanarkshire) on their TIF projects, which are at various stages of advancement. The Edinburgh Leith Waterfront TIF remains under discussion with City of Edinburgh Council as, following the takeover of Forth Ports, it has not been possible to make any tangible progress on the project as approved in 2011.

The TIF pilot programme is into its operational phase with 2 projects now in construction: the Glasgow Buchanan Quarter TIF, which has a city centre retail focus; and Falkirk’s Grangemouth TIF, which has a petrochemicals/ logistics focus. TIF projects will deliver an estimated £9m of public sector enabling works in 2014-15 and the programme is forecast to deliver up to £261m of public sector investment over the period from 2013-14 to 2023-24. Private sector investment of around 5 times this amount (c. £1.3bn) is anticipated to be leveraged.

In parallel SFT has led work to develop further approaches to incentivise economic growth and investment. Agreement in principle of the City of Edinburgh Council’s St James Quarter Regeneration Accelerator Model (RAM) project to see £61m of public sector infrastructure delivered in the area. Demolition of the existing entre and construction is set to start in 2015, with the owners of the St James Centre starting the process to procure some £400m of construction contracts. SFT continues to work with Scottish Government and the Scottish Cities Alliance to consider the wider application of this approach in Scotland’s cities.

Investing for growth as set out above, and the subsequent private sector investment, is estimated to generate over £1bn GVA per annum for the Scottish economy and support up to 15,000 jobs.

5. Economic impact

The economic impact of infrastructure investment is high compared to other areas of expenditure. For the short run, the CBI and others have commented on its high multiplier effect, generating £2.84 of total economic activity in the UK for every £1 spent on construction. For the longer term, the Group
of Twenty (G20) finance ministers and central bank governors stated in their communiqué from Sydney in February that higher infrastructure investment is crucial for the global economy’s transition to stronger growth and the October 2014 IMF World Economic Outlook concluded “In countries with infrastructure needs, the time is right for an infrastructure push. Borrowing costs are low and demand is weak in advanced economies.... Public infrastructure is an essential factor of production. Increasing public infrastructure investment raises output in the short and long term, particularly during periods of economic slack and when investment efficiency is high.”

The most recent “GDP - 2014 Quarter2” Scottish Government Statistical Bulletin shows strong GDP growth (table below) in the construction sector over the 18 month period from Q1 2013.

<table>
<thead>
<tr>
<th>GDP at constant basic prices</th>
<th>Total GDP</th>
<th>Production</th>
<th>Construction</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Scotland</td>
<td>UK</td>
<td>Scotland</td>
<td>UK</td>
</tr>
<tr>
<td>2013 Q1</td>
<td>0.2</td>
<td>0.5</td>
<td>-0.1</td>
<td>0.4</td>
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<tr>
<td>2013 Q2</td>
<td>0.9</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
</tr>
<tr>
<td>2013 Q3</td>
<td>0.5</td>
<td>0.9</td>
<td>-1.3</td>
<td>0.7</td>
</tr>
<tr>
<td>2013 Q4</td>
<td>0.3</td>
<td>0.6</td>
<td>-0.2</td>
<td>0.6</td>
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<tr>
<td>2014 Q1</td>
<td>1.0</td>
<td>0.7</td>
<td>2.1</td>
<td>0.9</td>
</tr>
<tr>
<td>2014 Q2</td>
<td>0.9</td>
<td>0.9</td>
<td>0.3</td>
<td>0.2</td>
</tr>
</tbody>
</table>

From Q1 2013 to Q2 2014 growth in the construction sector in Scotland has totalled 9% over that 18 month period compared to 7.6% in the UK as a whole.

New orders are also strong with the most recent October 2014 industry statistics from Barbour ABI showing 21% of UK construction contracts and 53% of infrastructure contracts awarded being in Scotland. Within these figures, two NPD projects – the Aberdeen Western Peripheral Route and Dumfries and Galloway Hospital projects - were mentioned as particular drivers alongside one onshore wind farm, demonstrating that the NPD programme is making a difference to the construction sector and economy overall.

The following diagram shows percentage changes in infrastructure activity compared to the same month last year. Scotland’s infrastructure activity has risen by 34.4% when compared with September 2013.

Source: Barbour ABI Oct14 Market Review
6. Conclusion
Overall SFT is engaged across all of the major portfolios. Our programmes are delivering additional infrastructure investment, which has been recognised by G20 Finance Ministers as crucial for transition to higher growth, and are supporting thousands of jobs in the construction industry across Scotland. In addition, they are contributing to the transition to a low-carbon economy by replacing old building with modern, energy-efficient ones. Crucially they are also supporting public service reform and budgetary savings by providing space-efficient places for the delivery of highly-connected public services. We will be pleased to discuss these and any other aspects of SFT’s work with the Committee.

Scottish Futures Trust
29 October 2014
Annex 1 SFT Letter to John Swinney
Dear John,

**NPD PROGRAMME CAPITAL PROFILE**

I attach the annual update on the profile of capital investment projected to be delivered through the NPD programme. Across the programme more than £700m is already in construction with a further £1bn of contracts to be signed over the next 8 months.

At £2.5bn, and recently extended to £3.5bn, The NPD programme remains one of the largest of its type in Europe per head of population. It is supporting thousands of jobs in the Scottish construction industry and the associated design professions as projects move through their development stages into construction. The impact of NPD investment goes far beyond construction as, in an era of reduced capital budgets, the early commitment to vital projects, such as the Aberdeen Western Peripheral Route, acts as a catalyst to private investment with commercial development already taking place along the proposed line of the road.

The NPD programme is delivering competitive prices for both construction and finance, with recently closed projects in NHS Ayrshire and Arran and Ayrshire College achieving construction prices below the taut caps set for those projects by SFT. The most recent contract signature, for the NHS Ayrshire & Arran Acute Mental Health and North Ayrshire Community Hospital project in June this year, was achieved in only 17 months from launching the procurement – roughly half the historic norm quoted by HM Treasury. It was financed by the European bank Nord LB at highly competitive rates following a funding competition in which several financial institutions priced the investment opportunity keenly.

Last year as part of the scrutiny of the budget I stated that the estimated profile of capital investment was dependent on a wide range of factors, “…..given the complexity of the projects, the need to source competitive finance, often from international sources, and the more routine challenges such as land acquisition and planning consent, some uncertainty remains.”. This update shows that the uncertainty persists: in the three year period from 2013-2016 the aggregate profile is reasonably stable however some movement forward into 2013-2014 has occurred and some movement back into 2015-16 is projected. I know from appearing at the Finance Committee that Parliament is keen to be able to understand the investment profile, and the reasons for revisions to the projection. The table at Annex 1 therefore:

a) separates out the single largest factor which has caused us to revise our estimate: the excellent value for money achieved on the M8 / M73 / M74 Motorway Improvement NPD project, by way of a prior-year adjustment which takes £148m out of the three-year 2013-2016 total;
b) is based on dates and value estimates from Local Authorities, Health Boards and other procuring bodies in August 2014, and is consistent with the recently published Infrastructure Investment Plan update¹.

c) incorporates an allowance by SFT for remaining uncertainty in the development of these complex projects based on historic precedents by way of an adjustment in 2015-2016.

A summary table of the profile shows:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>2013-2014</td>
<td>185</td>
<td>156</td>
<td>177 actual</td>
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<tr>
<td>2014-2015</td>
<td>809</td>
<td>757</td>
<td>614</td>
</tr>
<tr>
<td>2015-2016</td>
<td>932</td>
<td>865</td>
<td>954</td>
</tr>
<tr>
<td>Total 2013-2016</td>
<td>1,926</td>
<td>1,778</td>
<td>1,745</td>
</tr>
</tbody>
</table>

Whilst this is essentially a forward looking process I’m pleased to be able to tell you that the investment delivered in 2013-14 was £177m, which is £21m (13%) higher than our estimate, adjusted for the M8 savings, made this time last year.

The three-year total investment profile is projected by procuring bodies to be higher than the adjusted estimate from last year. However, in SFT’s estimation it could out-turn lower given historic precedents of the potential for time scales to move as these complex projects are finalised to deliver the best possible long-term value and user experiences over their life cycle. We always press for pace and have taken proactive action including: issuing further standardised commercial documentation to avoid protracted negotiation, revising payment terms for the (largely SME) design teams involved in hub project development to allow them to accelerate resource input, agreeing inflation allowances with Local Authorities to incentivise timely delivery when realistic programmes have been agreed and managing the majority of financing competitions centrally to speed decision making.

These steps continue to contribute to programmes shorter than historic norms but we remain convinced that getting the right project, and the right deal is more important in the long run than delivering a contract signature in a particular month. Should SFT identify a significant issue on any project through our key-stage review process, we would not hesitate to require additional time and effort to be spent on a project for the issue to be properly resolved. This would be mitigated, where technically possible and commercially prudent, through “early works agreements” which will be implemented to maintain the overall pace of construction where possible. The £1bn programme extension will benefit from the lessons learned in delivering the current projects and we are currently putting together detailed implementation plans. Support from the Infrastructure Investment Board, providing governance oversight and impressing on procuring Authorities the drivers for value which you wish to see across the programme continues to be essential for the pace of that implementation.

The figures which we have provided in Annex 1 are a projection of capital investment, not a budget. In recognition of the uncertainty described in this projection, which naturally increases further out in

¹ http://www.scotland.gov.uk/Topics/Government/Finance/18232/IIP/ProjectPipelineAug2014
time, we have left the estimates from procuring bodies intact but made a programme level allowance of -£100m in the 2015-2016 total. This adjustment leaves the 3-year total investment projection at £1,745m, 2% under that made last year.

Within this total, there has been some movement between years and the figures show a -£142m reduction in anticipated activity in 2014-2015 largely offset by increases in 2013-2014 and 2015-2016. Annex 2 sets out explanations for these movements which can be summarised as:

- in **Community Health** projects, a re-scheduling of approximately £60m is due in the main to procuring authorities taking additional time to scope affordable projects to deliver joined-up services with social care for the long term. This has involved significantly increased joint provision with local authorities in pursuit of the health and care integration agenda but has resulted in land, joint budgeting and project scope issues to be resolved.

- In **Schools** projects around £80m of rescheduling has occurred with over half being attributable to specific project events such as the inability to proceed on common good land, the outturn of statutory consultation processes and land acquisition / ground conditions issues. In these situations, Authorities had proceeded at risk in order to potentially accelerate projects but events have turned against them. SFT supports elements of risk taking and in most cases the work done to date can be re-used once the issue has been resolved leading even now to a more rapid ultimate project delivery than if the issue had been 100% resolved prior to the project proceeding. In other cases, projects have taken longer than originally anticipated by the procuring authority for a variety of reasons including commercial issues in reaching agreements with the private sector. On both the public and private sector sides, leadership focus could lead to more rapid resolution of some of these points, and SFT is working across the programme to support this.

Overall, the program is at a busy stage, with intensive activity across the project development, deal finalisation and construction stages of many projects. In the next 8 months, approximately £1bn of private sector finance is expected to be invested in Scotland’s infrastructure as deals reach financial close. I am confident that my team, working with procuring authorities across Scotland will deliver excellent value for money for this financing, and that the additional construction activity delivered over and above traditional capital budgets will continue to support thousands of jobs in the construction and related industries over the coming years.

Yours sincerely

Barry White
Chief Executive
### Annex 1  Non-Profit Distributing Pipeline

- Estimated Capital Investment Profile (£m cash terms)

<table>
<thead>
<tr>
<th>Year</th>
<th>Project</th>
<th>Draft Budget 2014/15</th>
<th>Draft Budget 2015/16 (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013-14</td>
<td>M8 M73 M74 Motorway Improvements (2)</td>
<td>53</td>
<td>53</td>
</tr>
<tr>
<td></td>
<td>A90 Aberdeen Western Peripheral Route/Balmedie –Tipperty</td>
<td>-</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Schools</td>
<td>15</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>Colleges</td>
<td>61</td>
<td>63</td>
</tr>
<tr>
<td></td>
<td>Community Health</td>
<td>27</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>Standalone Health (various)</td>
<td>-</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td><strong>2013-14 TOTAL</strong></td>
<td><strong>156</strong></td>
<td><strong>177</strong></td>
</tr>
<tr>
<td>2014-15</td>
<td>M8 M73 M74 Motorway Improvements (2)</td>
<td>95</td>
<td>95</td>
</tr>
<tr>
<td></td>
<td>A90 Aberdeen Western Peripheral Route/Balmedie –Tipperty</td>
<td>106</td>
<td>107</td>
</tr>
<tr>
<td></td>
<td>Schools</td>
<td>226</td>
<td>144</td>
</tr>
<tr>
<td></td>
<td>Colleges</td>
<td>162</td>
<td>146</td>
</tr>
<tr>
<td></td>
<td>NHS Lothian Royal Hospital for Sick Children/Department of Clinical Neurosciences</td>
<td>18</td>
<td>19</td>
</tr>
<tr>
<td>Description</td>
<td>2015-16</td>
<td>2016-17</td>
<td></td>
</tr>
<tr>
<td>-----------------------------------------------------------------------------</td>
<td>---------</td>
<td>---------</td>
<td></td>
</tr>
<tr>
<td>NHS Ayrshire &amp; Arran Acute Mental Health and North Ayrshire Community Hospital</td>
<td>27</td>
<td>21</td>
<td></td>
</tr>
<tr>
<td>NHS NSS Scottish National Blood Transfusion Service National Centre</td>
<td>13</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>NHS Dumfries &amp; Galloway Acute Services Redevelopment Project</td>
<td>0</td>
<td>21</td>
<td></td>
</tr>
<tr>
<td>Community Health</td>
<td>110</td>
<td>51</td>
<td></td>
</tr>
<tr>
<td><strong>2014-15 TOTAL (3)</strong></td>
<td><strong>757</strong></td>
<td><strong>614</strong></td>
<td></td>
</tr>
<tr>
<td>2015-16 M8 M73 M74 Motorway Improvements (2)</td>
<td>101</td>
<td>101</td>
<td></td>
</tr>
<tr>
<td>A90 Aberdeen Western Peripheral Route/Balmedie –Tipperty</td>
<td>147</td>
<td>181</td>
<td></td>
</tr>
<tr>
<td>Schools</td>
<td>220</td>
<td>326</td>
<td></td>
</tr>
<tr>
<td>Colleges</td>
<td>58</td>
<td>66</td>
<td></td>
</tr>
<tr>
<td>NHS Lothian Royal Hospital for Sick Children/Department of Clinical Neurosciences</td>
<td>110</td>
<td>99</td>
<td></td>
</tr>
<tr>
<td>NHS Ayrshire &amp; Arran Acute Mental Health and North Ayrshire Community Hospital</td>
<td>23</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>NHS NSS Scottish National Blood Transfusion Service National Centre</td>
<td>24</td>
<td>22</td>
<td></td>
</tr>
<tr>
<td>NHS Dumfries &amp; Galloway Acute Services Redevelopment Project</td>
<td>93</td>
<td>119</td>
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<tr>
<td></td>
<td>2013-14 to 2015-16 investment total</td>
<td></td>
<td></td>
</tr>
<tr>
<td>--------------------------------</td>
<td>-------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Community Health</td>
<td>89</td>
<td></td>
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<tr>
<td></td>
<td>115</td>
<td></td>
<td></td>
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<tr>
<td>Pre-contract uncertainty (4)</td>
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</tr>
<tr>
<td></td>
<td>-100</td>
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<tr>
<td>2015-16 TOTAL (3)</td>
<td>865</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>954</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>1,778</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,745</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note
1. Estimated profile of construction activity associated with Scottish Government revenue funded projects in the budget period based on dates and values updated by Local Authorities, Health Boards and other procuring bodies for the August 2014 Infrastructure Investment Plan update.

2. Investment values for the M8 M73 M74 motorway improvements project have been restated in the Draft Budget 2014-15 column to reflect the significant value for money impact of the contracted value being well under budget, and allow comparison net of this effect to be made.

3. Totals may not sum due to rounding.

4. Across the programme deals are progressing faster than historic norms. Uncertainty remains in the progress of projects yet to be contracted. It is critical that projects are finalised to deliver the best possible value for money and user experience over their life. Reflecting the greater uncertainty further out in time, a programme level adjustment to the 15-16 total has been made.
Notes to table:

**Update on the 2013-14 capital investment delivered**
£21m more capital investment in the NPD programme was delivered in 2013/14 than the forecast from last year adjusted for the M8 being under budget. Overall there are 10 revenue funded projects with a value of over £760m which have reached financial close to date and are in the construction phase or open to deliver services across the education, health and transport sectors.

**M8 M73 M74 Motorway Improvements**: Project commenced construction in February 2014. Strong competition and robust procurement process resulted in a final tender price significantly under budget. Over the period 2013-14 to 2015-16 the value achieved takes £148m out of the anticipated profile.

**Aberdeen Western Peripheral Route (AWPR)**: Preferred bidder has been appointed and pre-start works agreement signed in August 2014 allowing preparatory works to commence.

**Schools**: Significant construction activity has occurred across the schools programme to date including James Gillespie’s High School in Edinburgh, Alford Community Campus in Aberdeenshire, Levenmouth High School in Fife and Wick High School projects.

For a number of reasons local authorities and their partners have changed their delivery dates on the schools programme to ensure that land, planning and wider value for money considerations are properly resolved resulting in a lower forecast for 2014/15 and a higher forecast in 2015/16 when compared with estimates last year.

**Colleges**: Inverness, Ayshire and City of Glasgow College projects are now all in the construction phase with Inverness College and the Glasgow Riverside Campus due to reach completion in summer 2015.

**NHS Lothian Royal Hospital for Sick Children/Department of Clinical Neurosciences**: NHS Lothian are currently working with their preferred bidder to reach financial close in 2014.

**NHS Ayrshire & Arran Acute Mental Health and North Ayrshire Community Hospital**: Following a 17 month procurement the project started on site on programme and under budget.

**NHS NSS Scottish National Blood Transfusion Service National Centre**: Preferred bidder has been appointed and financial close expected in 2014.

**NHS Dumfries & Galloway Acute Services Redevelopment Project**: Preferred bidder recently appointed. NHS Dumfries and Galloway are working with their bidder to achieve financial close in early 2015.

**Community Health**: The Aberdeen Health Village and Forres, Tain and Woodside health centres delivered through the hub programme are all now open. The 14-15 profile also includes work on primary care centres in Kilsyth, East Kilbride and Wishaw for NHS Lanarkshire alongside health and community centres for NHS Greater Glasgow and Clyde one of which is a joint facility with East Renfrewshire Council, phase 1 of the redevelopment of Royal Edinburgh Hospital Campus, and health centres at Firhill, Muirhouse and Blackburn.

The 2014/15 investment has been reprofiled showing a larger proportion falling into 2015/16. This predominantly reflects the decision of health boards and their delivery partners to reschedule dates allowing rescoping of a number of projects to deliver increased service integration across health and community care, and review the corresponding cost movements to support long term value for money and affordability.
Annex 2 Programme Movements

Community Health
The development of the Lanarkshire Health Centres Bundle Project in 9 months from New Project Request to financial close shows that a well-resourced hub company and health board can deliver well scoped projects in a timely manner. This rapid progress has not been achieved in all cases:

Blackburn / Muirhouse / Firrhill – a programme extension of around 6 months for changes in scope in the Muirhouse Project and West Lothian Council capital funding budget approval alongside NPD funding reduction for the Blackburn Project.

Maryhill / Eastwood – programme extension of about a year to deliver clean title, complete NHSGGC scope changes (including for new NHS design guidelines), reaching commercial agreement on costs with hub West and replacing a facilities management contractor with whom terms could not be agreed during the stage 2 design development.

Gorbals / Woodside – programme extension of about 15 months to finalise Glasgow City Council involvement in the project, resolve ground conditions issues and value engineer an affordable scope.

NHS Lanarkshire Bundle - value decrease in 2014-2015 due to revised construction phasing agreed at financial close and improved value for money through receipt of a £5m capital contribution from North Lanarkshire Council

Schools
Around £80m of rescheduling has occurred with over half, approximately £46m attributed to specific project major issues such as:

East Renfrewshire – Barrhead High School – Inability to progress with chosen site due to Common Good land title – alternative site being sought (9 months)

West Dunbartonshire – Our Lady and St Patrick’s High School – statutory consultation did not support the chosen site – alternative site identified with further statutory consultation needed (9 months)

Moray – Elgin High School – Redesign required after the discovery of peat on site (9 months)

South Ayrshire – Ayr Academy – movement between sites after agreement on land purchase with University of West of Scotland resulting in a very positive educational campus solution (7 months)

North Ayrshire – Ardrossan and Auchenharvie Academies – outcome of statutory consultation – project not progressed. 18 months required to develop replacement project in Largs

Approximately £36m (45%) is attributed to changes in funding arrangements and general project issues such as: agreeing commercial terms between the public and private sectors; tendering of works packages; and resource constraints in the public and private sectors.