KPMG

WRITTEN SUBMISSION

1 Prioritisation of Infrastructure Investment to Deliver Economic Growth

1.1 Introduction

We are pleased to submit this evidence to the Infrastructure and Capital Investment Committee as part of its consideration of the Draft Budget 2015-16, focusing on the National Performance Framework and its key Purpose Targets of: Economic Growth; Productivity and Participation. Prioritisation of investment was a key theme in the Committee's Report and Recommendations on the draft Budget 2014-15.

In that context, we would like to draw the Committee's attention to a new method of prioritising investment to target economic growth, which underpins the Glasgow City Deal's £1.1bn Infrastructure Fund. This approach to prioritisation is being considered by several other Scottish cities

The eight authorities of the Clyde Valley[1]; Scottish and UK Governments signed the City Deal on 20 August 2014. The Scottish Government will provide significant funds for the Glasgow City Deal – some £500m over 20 years if economic objectives are met – along with a further £500m from UK Government. The start of that funding appears in the 2015-16 Draft Budget as £30m in Table 12.17, p 134. This funding line has the potential to make a highly significant impact on economic growth and productivity not just for the Glasgow City Region, but for the wider Scottish economy. The benefits of the Infrastructure Fund's programme of 20 projects are estimated to deliver a sustained annual uplift to the economy of the region of £2.2bn, including an overall 29,000 additional job opportunities; significant improvements in productivity and leveraging £3.3bn of private sector investment as a result.

This evidence explores the concepts of economic prioritisation of infrastructure, and points to lessons for the future.

1.2 How Infrastructure drives economic growth

Infrastructure investment is one way to influence economic output and productivity by enhancing access – or 'connectivity' – to key markets. A location's access to labour, businesses and customers are known to be

[1] East Dunbartonshire, East Renfrewshire, Glasgow City, Inverclyde, North Lanarkshire, Renfrewshire, South Lanarkshire and West Dunbartonshire Councils

key factors in attracting investment and influencing the location decisions of people and businesses.

It is possible to increase connectivity through a range of infrastructure investments:

- Improving transport networks can reduce transport costs and bring places 'effectively closer' to one another; similarly,
- Increasing the supply of housing near to employment opportunities provides businesses with access to a wider pool of labour and residents with a larger pool of job opportunities; and
- Regeneration projects (that unlock housing or employment sites) can also result in wider labour and business markets.

Investment in these areas therefore need to be planned together in order to produce complementary effects to maximise a region's economic potential.

1.3 Prioritising infrastructure projects to maximise economic growth

There is clearly strong support within the Scottish Parliament for infrastructure investment to be targeted to deliver economic growth – especially when capital budgets are constrained

The difficulty up until now has been in having a robust approach which would allow public authorities to prioritise projects to meet that objective. Current approaches evaluate transport, housing, and regeneration investment separately, and do not allow decision-makers to determine the optimum combination of these elements across different sectors on the basis of their economic impact. For example, transport projects (the sector for which central government appraisal guidance is the most developed) are traditionally appraised based on their social costs and benefits, such as journey time savings for users, impacts on CO2 emissions, accidents and so on. These types of appraisal, including STAG (Scottish Transport Appraisal Guidance), are important in assessing individual projects, but, as the Scottish Government's response to the Committee's last report indicated, they are not suitable as a prioritisation tool within the transport sector. And are certainly not designed to appraise projects across different sectors.

> "Prioritisation using STAG would be inappropriate and difficult to apply as it would involve giving greater importance (weighting) in a STAG study to one or more criterion and/or sub-criterion. Rather the STAG guidance is an aid to decision makers to allow them to make informed choices."[2]

[2] Letter of 2 February 2014 from the Deputy First Minister and Cabinet Secretary for Infrastructure, Investment and Cities in reponse to the Committee's report on the Draft Budget 2014-15

1.3.1 **Single Assessment Framework**

Therefore to give effect to a goal of increasing economic growth, City regions[3] have used new approaches to economic modelling to measure the impact of all types of infrastructure investment on economic outcomes. This has typically meant developing a "Single Assessment Framework", which using a unified analytical approach, is able to:

- Capture the impacts of how investments can change the size, location, and type of economic activity – including jobs and productivity impacts;
- Provide a level playing field across different sectors; and,
- Measure the impact of infrastructure investment on any secondary social or distributional objectives.

An overarching Single Assessment Framework does not supersede the need for rigorous individual project appraisal in the usual way e.g. in line with HM Treasury "Green Book" guidance on investment appraisal or STAG. But it does allow economic growth to be targeted as a key objective. Constituent projects are subsequently appraised in the usual manner, developing robust Business Cases to support the investment.

1.3.2 **Defining the Key Economic Objective – against which projects are prioritised**

If the objective is economic growth, the most common metric for measurement is Gross Value Added (GVA). GVA is a key local indicator of the state of the economy and is used as a proxy for economic growth, since it captures the following fundamental economic objectives: job creation; and productivity levels, which encompass the type and value of the jobs created.

Measuring the economic benefits clearly means little without reference to the cost of the investment. Including the whole-life cost side of the equation ultimately allows many different types of investments to be appraised and prioritised according to their medium term economic output (as measured by GVA) per £ invested, and therefore ensures that any Infrastructure Fund delivers best value for the public pound.

1.3.3 **Supporting objectives**

A number of subsidiary objectives have been used in a number of City Deal Infrastructure Funds to ensure that the benefits of this growth are equitably spread, or assist in supporting complementary social objectives. Examples of such supporting objectives are: a minimum uplift in economic activity across every part of a defined geography, alleviation of social deprivation (typically targeting deprived areas using SIMD data), and/or contribution to low-carbon objectives.

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[3] Manchester, Leeds, Cambridge and Glasgow City Regions supported by KPMG

1.3.4 Economic versus social infrastructure investment

It is important to note that the Single Assessment Framework has not been designed as a method of prioritising *social* infrastructure (for example schools and hospitals). Such investments are typically made with a view to delivering long-term social policy objectives and enhancing service provision. Decisions on which social infrastructure projects to prioritise are taken in that context.

2 What are the lessons for Scotland more widely?

2.1 Economic prioritisation to drive growth

For many areas, targeting economic growth represents a significant departure from previous methods for prioritising funding, as it requires political commitment to an economic outcome, rather than to a series of individual projects or programmes. Scotland is already part way there in that sustainable economic growth has been the stated primary purpose of the existing and previous Scottish Government administrations.

As the Scottish Parliament takes on increasing tax raising powers, through the Scotland Act 2012 and with further devolution following the Smith Commission, it will have even more of an interest in policies to deliver economic growth.

For every additional pound in GVA growth, the Office for Budget Responsibility estimates suggest that 38p is raised in additional tax income e.g. a permanent uplift in GVA of £1bn would generate £380m in additional tax income. Under the Scotland Act 2012, 19% of that figure – some £72m - would flow directly to the Scottish Parliament through devolved taxes[4]. That percentage is likely to increase further following the Smith Commission's work.

Understanding which infrastructure investments drive economic growth will therefore become an increasingly important issue for the Committee. There are now robust tools and techniques to support assessment and prioritisation on that basis. As part of that analysis, productivity is a key element – an area where Scotland has lagged behind in relevant international comparisons.

There are therefore useful lessons in the approach taken in the Glasgow Infrastructure Fund, which could be used elsewhere in Scotland.

We would be happy to discuss further with the Committe

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[4] Government Expenditure and Revenue Scotland 2012-13, published by Scottish Government March 2014

What is the Glasgow City Deal and how has it used this method of prioritisation?

Glasgow City Deal

In January 2013 Glasgow and its partner Clyde Valley authorities embarked on a scoping study to determine whether an Infrastructure Fund could meet the area's key objectives of:

- Closing the economic 'output gap' with top performing European Cities; and
- Ensuring that economic growth benefits all the residents of Glasgow – including the area's most deprived neighbourhoods.

This study drew on the existing economic evidence, as well as extensive stakeholder analysis, to: evaluate the economic geography of the city region; identify key infrastructure constraints; and assess existing approaches to investment prioritisation and appraisal.

Approach focused on economic impact

The study identified that there was a significant need for additional infrastructure investment and that a more coordinated approach to delivering infrastructure would maximise the impact of this investment. Over the course of the next 15 months, Glasgow and its partners developed a programme of investment focused on maximising economic growth, as well as targeting equitable spread of benefits and alleviation of social deprivation. The 20 projects in the programme were selected following rigorous economic modelling to identify the optimum package of interventions to deliver the highest GVA return for every £1 of public money spent.

Estimate benefits

The 10-year programme will cover expenditure of £1.13bn, and in August 2014 the Scottish and UK governments agreed to contribute £500m each, over 20 years, subject to programme and economic milestones being met at Gateway Reviews in Years 5, 10 and 15. A sustainable annual uplift to the region's GVA of £2.2bn is expected to be delivered by the programme.

Other expected benefits from the City Deal are set out in the signed City Deal document:

"*This City Deal is one of the largest ever agreed. It is an agreement between: the UK Government; the Scottish Government; and the eight local authorities across Glasgow and Clyde Valley. This deal provides an example of what can be achieved when all levels of Government,* *businesses, universities and the voluntary and community sector work together to promote economic growth. Over its lifetime local leaders in Glasgow and the Clyde Valley estimate this City Deal will:*

- *Support an overall increase in the economy of around 29,000 jobs in the city region.*
- *Work with 19,000 unemployed residents and support over 5,500 back into sustained employment.*
- *Secure £1 billion of Scottish Government and UK Government capital funding to support proposed infrastructure investment programme for the area. This will be complemented by a minimum of £130 million of investment from Glasgow and Clyde Valley local authorities.*
- *Lever in an estimated £3.3 billion of private sector investment into the proposed infrastructure investment programme.*
- *Spread the benefits of economic growth across Glasgow and Clyde Valley, ensuring deprived areas benefit from this growth.* "

Opportunities for other Scottish Cities

The Scottish Cities Alliance conducted a study, supported by KPMG, on the applicability of a City Deal Infrastructure Fund approach for the remaining Scottish Cities and City Regions between February and June 2014. Its member cities and city regions are now considering how to take forward the recommendations, building on previous work to develop individual City infrastructure plans