FINANCE COMMITTEE

Tuesday 19 September 2000
(*Morning*)

£5.00

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FINANCE COMMITTEE
22ND Meeting 2000, Session 1

CONVENER

*Mike Watson (Glasgow Cathcart) (Lab)

DEPUTY CONVENER

*Elaine Thomson (Aberdeen North) (Lab)

COMMITTEE MEMBERS

*Mr David Davidson (North-East Scotland) (Con)
*Rhoda Grant (Highlands and Islands) (Lab)
Mr Adam Ingram (South of Scotland) (SNP)
George Lyon (Argyll and Bute) (LD)
*Mr Kenneth Macintosh (Eastwood) (Lab)
*Mr Keith Raffan (Mid Scotland and Fife) (LD)
*Dr Richard Simpson (Ochil) (Lab)
Mr John Swinney (North Tayside) (SNP)
*Andrew Wilson (Central Scotland) (SNP)

*attended

ADVISERS

Professor Brian Ashcroft
Professor Irvine Lapsley

CLERK TO THE COMMITTEE

Callum Thomson

SENIOR ASSISTANT CLERK

Anne Peat

ASSISTANT CLERK

Sean Wixted

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 19 September 2000

(*Morning*)

[THE CONVENER *opened the meeting at 10:05*]

The Convener (Mike Watson): I call the meeting to order. Please switch off mobile phones and set pagers to buzz.

The agenda has been circulated as usual. Members have two additional papers before them. One is from the Minister for Finance and we will deal with it under item 4. The other is a note with comments from Professor Lapsley on resource accounting and budgeting, which we will deal with under item 3.

I have had apologies from George Lyon, Adam Ingram and John Swinney.

The Convener: I invite the committee to agree that we take items 4 and 5 in private. Is that agreed?

Members *Indicated agreement.*

European Structural Funds

The Convener: I move now to the committee's inquiry into European structural funds. Members have a copy of a letter that I sent last week to the Secretary of State for Scotland. Subsequent to our meeting a fortnight ago at which we discussed the matter, there was some unfortunate and ill-informed reporting in the press that suggested that somehow the committee was slapping down the Secretary of State for Scotland for refusing to address us. We have not, however, invited John Reid to address the committee; he was invited to attend the European Committee.

We discussed a letter that John Reid wrote to the Minister for Parliament. The letter informed our discussion, but it was misunderstood by some reporters. I hope that the letter that I have written to the Secretary of State for Scotland meets with the approval of members. We understood that we should have access to UK ministers in exceptional circumstances—in anything other than exceptional circumstances, we would not want to invite a UK minister.

Subsequent to our meeting a fortnight ago, I met the Presiding Officer, who had met the Secretary of State for Scotland that day. The Presiding Officer was amenable to the suggestion that committees should have the opportunity to invite UK ministers to come before them when they think that that is necessary.

It was suggested that I should propose to the conveners liaison group that that body might act as a siphon for requests from committees for UK ministers. I have asked for that item to be placed on the agenda of the conveners liaison group's meeting, which will be held a week today. My suggestion has met with a positive response from the conveners to whom I have talked informally and it has been agreed that it might be a way of ensuring that there is support from other committees for a request to invite a UK minister. Also, the request might carry more weight if it is made by the conveners liaison group, rather than by a committee.

We have a response from the Treasury, which we will come to in a minute. First, I invite comments on the matters that I have covered so far.

Andrew Wilson (Central Scotland) (SNP): Why was that matter not raised at the previous meeting of the Finance Committee? It is within your remit to send a letter to the Secretary of State for Scotland without discussing it with the committee, but I do not recall any press coverage that quoted members of the Finance Committee in the manner that you suggest.

The letter that you sent to the Secretary of State for Scotland refers to a message that he left for you. We have no note of what was in that message. It would be useful to see that correspondence—which has obviously taken place outside the Finance Committee—and the other papers.

At the meeting on 7 March, reference was made to the initial options paper that included an invitation to the Secretary of State for Scotland. I am bemused about why that invitation has not been sent, given that it was in that paper and was mentioned by you at that meeting.

This and the next item on the agenda that we will discuss take us no further than we were on 7 March—we have no evidence before us that will allow us to proceed. The letter from the Treasury is not useful. There are a number of matters that are still to be discussed.

The Convener: The matter was not discussed last week because it was not on our agenda. Andrew Wilson might remember that our meeting last week was not a scheduled meeting. We discovered that we had to deal with matters relating to the Transport (Scotland) Bill. The meeting was meant to be an informal briefing.

The message from the Secretary of State for Scotland to which Andrew Wilson referred was a telephone message that he left on the night of Tuesday 5 September—the day when the coverage appeared. The first notice that I had of the situation was on Ceefax. I did not refer to members of the committee being quoted. Dr Richard Simpson was quoted extensively in the coverage, but his words were taken out of context. His comments were given a meaning in many of the reports that was different from the meaning that he intended. The bottom line is that the committee did not invite the Secretary of State for Scotland, although newspaper reports suggested that we were miffed that he had refused to appear before us.

Andrew Wilson also referred to the meeting on 7 March. I remember the discussion, but I do not remember an invitation to the Secretary of State for Scotland being discussed since then. I do not remember the committee ever saying that it had decided to invite the Secretary of State for Scotland, or that it tried to set a date for such a meeting. However, if that is in the *Official Report*, I will not refute it. I am aware that we have discussed the matter a number of times. I do not deny that it was discussed when we embarked on the inquiry, but I am not aware that it has been suggested again that the Secretary of State for Scotland should give evidence to the committee. The clerks will keep me right if I am straying off course.

I will deal in a minute with the points that Andrew Wilson made about the letter from the Treasury. We have received nothing in writing from the Secretary of State for Scotland. He wanted simply to clarify that he thought that it was unfortunate that it was being reported that there was disagreement between his office and the committee when that was not the case. My letter was intended to reassure him that that view was correct.

Andrew Wilson: Can we invite people to give evidence to the committee? We are the best part of six months into the inquiry and no letter has gone to the Secretary of State for Scotland, which strikes me as odd. It might be most important that we speak to the Treasury, but all the relevant bodies should be invited. I am surprised, given what is in the *Official Report* of that first meeting, that that has not taken place. I had assumed that the process of sending out invitations was on-going and that it was in the hands of you and the clerks.

The Convener: That is not strictly fair. The matter is in the hands of all the committee's members. You could have followed up the invitation if you had wanted to. This is the first time since March that the issue has been mentioned, as far as I am aware, but that is not the issue. We invited the Chancellor of the Exchequer. I understand that the European Committee invited the Secretary of State for Scotland, so such an invitation was not on our agenda after March.

Mr Keith Raffan (Mid Scotland and Fife) (LD): I have always thought that it was odd that the Secretary of State for Scotland wrote to the Minister for Parliament in the first place. The Minister for Parliament is a member of the Executive and the committee is dealing with a parliamentary matter. I do not understand why a member of the Executive—who has no locus when it comes to the work of committees, although he would like to have—was contacted in this regard by the Secretary of State for Scotland. That was inappropriate.

Now that the Secretary of State for Scotland has done what he should have done and spoken to the Presiding Officer, perhaps the convener can illuminate us on the subject of the last line of his letter, which talks about an "understanding" that would avoid such events recurring. I do not know how much the convener knows about that understanding, but I would like to have further details of it.

My final point concerns the conveners liaison group. I get so fed up with the bureaucracy in this place. It grows and grows like Topsy. I suppose that it is fair enough to suggest that invitations to UK ministers should have the support of other conveners and I will not make a meal out of that.

However, I am concerned about the understanding that has been reached between the Secretary of State for Scotland and the Presiding Officer.

It would be helpful if the convener could provide us with some details. The Presiding Officer should either make a statement about the matter in the chamber or issue a written statement—as he has done frequently in the past—to give us an indication of what he has agreed with the secretary of state. We can then decide whether that is acceptable to the Parliament.

10:15

The Convener: The clerk and I met the Presiding Officer on 5 September, an hour or two before he met the secretary of state. It is entirely a matter for the Presiding Officer whether he makes a statement to Parliament or issues guidance on the issue. However, the understanding that was reached by the Presiding Officer and the secretary of state—as stated in the exchange of correspondence that took place, rightly or wrongly, between the Minister for Parliament and the Secretary of State for Scotland—is that UK ministers will give evidence to committees of the Scottish Parliament in exceptional circumstances. That understanding has been accepted by other committees, but I do not know whether it will be formalised. The Presiding Officer accepted it as reasonable in the circumstances.

At the end of the day, we cannot force UK ministers to appear before our committees, much as we might like to. We must reach an understanding that will allow that to happen in a spirit of co-operation. That is what this and the European Committee set out to do in the inquiry.

Mr David Davidson (North-East Scotland) (Con): I apologise for being late; my train was delayed.

We have argued that, as a matter of principle, we should be able to gain access to Cabinet ministers and their civil servants—we should continue to hold the line on that. If we can achieve that through the conveners liaison group, that is well and good. I agree with Keith Raffan that we need a statement from the Presiding Officer, but I am concerned about the bureaucracy of the Parliament coming between a minister and a committee when the business of an inquiry involves only those two parties. It is for the committee to present its findings to Parliament, which it would do in due course.

For the Parliament to work, the Cabinet and the Executive need to show a spirit of good will. It is incumbent on them to play their part. The committees have worked well and will work even better as time goes on. We have buried the hatchet politically in order to get the job done. It is incumbent on the secretary of state, as a member of the Cabinet, to play his part and to volunteer information on when he would be prepared to appear before committees. The phrase "in exceptional circumstances" is not qualified or quantified. It would be helpful if that could be done.

The Convener: We will come back to that point. How can one qualify exceptional circumstances? They defy description.

Mr Davidson: We were not party to the discussion that took place between the secretary of state and the Presiding Officer. As you are in correspondence with the secretary of state, perhaps you could drop him a note asking him to clarify how he interprets the phrase "in exceptional circumstances".

The Convener: We could do that or we could ask the Presiding Officer to clarify it. However, I do not see how one can clarify exceptional circumstances.

Mr Raffan: That is the point. Exceptional to one person is not exceptional to another. It is a completely subjective definition. We might not be privy to what has happened, but I do not see how the Presiding Officer can—for want of another phrase—do a deal with the secretary of state on such an issue without consulting the Parliamentary Bureau and the conveners liaison group. It is more important that he consults the conveners liaison group than that he consults the Parliamentary Bureau, which has far too much power.

Dr Richard Simpson (Ochil) (Lab): To some extent, access to officials is more important than access to ministers when we are seeking clarification of what is happening at UK level. "Exceptional" should certainly not apply to officials. Your letter implies that, convener, but we should make it explicit.

If there is to be a protocol, which we are inching towards, it must be open and it must be discussed so that everyone understands what it is. We are creating something that we hope will last. This is not about only the present incumbent and the present Government; it is about the relationship between the Scottish Parliament and the UK Parliament.

In my view, "exceptional" should apply to UK ministers, apart from the Secretary of State for Scotland. He is our link to the UK Government, so he is in a different position from other ministers. If my memory serves me correctly, when we discussed this issue previously, I said that the circumstances in which we invite the secretary of state to appear before us should always be specific and defined. However, they should not necessarily be exceptional. "Exceptional" implies that the secretary of state is much more dissociated from the Scottish Parliament than he or she might be in future.

I welcome the fact that the Presiding Officer seems to be inching towards a protocol. That protocol should be open, discussed and defined. However, at this point I would not like the committee to commit to use of the word "exceptional", which appears in John Reid's letter, particularly with respect to the Secretary of State for Scotland.

Andrew Wilson: We should keep at the front of our minds the suggestion in John Reid's letter that committees would use the presence of UK ministers for partial political purposes. The tone and implications of that are unacceptable.

Although I was not at the debates that took place during the passage of the Scotland Act 1998, I understand that when the issue of the ability of committees of the Scottish Parliament to summon UK ministers was raised, ministers responded that such a power would not be necessary because the relationship between the two Parliaments would be so co-operative. Within a matter of months, that has been shown not to be the case. The Presiding Officer might want to consider that.

We cannot proceed with the inquiry until we obtain information from the UK Government, and that is not happening. We are now six months—half a year—into our inquiry. That situation is absurd.

Mr Kenneth Macintosh (Eastwood) (Lab): I do not think that we should stall the inquiry over the issue, but it needs to be resolved. I have slight reservations about referring the issue to the conveners liaison group, because that group does not yet have official status.

The Convener: No, but it will have. It will become an official body of the Parliament and will probably be called the conveners panel.

Mr Macintosh: If that is the case, I am happy that the CLG should deal with the matter. As Richard Simpson said, we are inching towards a protocol, which needs to be drawn up formally. At the moment we are not entirely clear on what the understanding is and we need more detail. A formal protocol might be necessary in future.

The Convener: I hope that the conveners will get together and ask the Presiding Officer to put such a protocol in place.

I do not think that we will get any further in our attempts to obtain information for the inquiry; we have probably got as far as we can. As Andrew Wilson said, the letter that we received from the Treasury contains virtually nothing new. I am not happy about the fact that the first half of several brief paragraphs is taken up with reiteration of the question. Basically, the letter refers us to the Scottish Executive. That is not helpful.

However, what is the point of continuing to bang on about the issue? The general principles that govern the relationship between the Scottish Parliament and its committees on the one hand and UK ministers on the other hand need to be established. If we continue to bang on about the difficulties that we have encountered in our inquiry, we might make that more difficult rather than facilitate it. We can discuss separately what we do about the inquiry, but we need to consider how we can take matters forward generally for the Parliament.

Mr Davidson: I was trying to take things forward. Given the amount of outstanding work that we have in other areas, would it be appropriate to suspend the European structural funds inquiry and deal with something else until the background is sorted out?

The Convener: For some months the inquiry has, in effect, been suspended. I would be happy to take advice from the clerk on that. There would be a purpose in suspending the inquiry formally only if we were able to come back to it in future and obtain information that is not currently available.

Mr Davidson: What is your view on that?

The Convener: I have no strong views either way. We enter into inquiries with a view to producing reports that shed light rather than heat. We do not have a huge amount of information—apart from the factual briefings that we have received from academics and from the Minister for Finance—to enable us to do that in this instance. If the committee believes that we should revisit our inquiry at a later date, I would have no objection to that. However, if we are to publish a report, it must say something that justifies our having conducted the inquiry.

Andrew Wilson: The situation is very serious—the committee has embarked on an inquiry into a reasonably important issue, but that inquiry has hit the rocks and been stalled by the inability or unwillingness of UK officials and ministers to give us the information that we require. Where does that leave the Scottish Parliament, the question of parliamentary sovereignty and the Parliament's ability to be accountable and to hold people to account for their actions?

If an inquiry such as this hits the rocks, what is the function of the Scottish Parliament? What are we here for? If we cannot report on issues such as this, what is the point of being here? I do not use the word crisis lightly, but it strikes me as odd that an inquiry in which the Finance Committee has been engaged for six months is being wrecked because the Treasury refuses to give us information. We cannot simply sit back and say that we will put off the inquiry for six months, at the end of which everyone will—some would hope—have forgotten what has happened. How will we answer for ourselves to people outside Parliament on the matter?

Elaine Thomson (Aberdeen North) (Lab): The issue affects every committee in the Parliament and it needs to be resolved for the whole Parliament, rather than only for the Finance Committee. The way forward is to discuss the matter in the appropriate places—in the conveners liaison group, with Sir David Steel and so on. It might be that we cannot proceed with the inquiry until a protocol is in place. Some of the language that Andrew Wilson used was a little heated. This is a new Parliament and we have always known that we would come across new situations constantly, for which we would have to develop protocols and good working practices. Clearly, this is one such situation.

The Convener: David Davidson suggested that we suspend the inquiry. Is the suggestion that we should suspend it formally, on the basis that some form of protocol will be issued that will enable us to take the matter forward in future?

Mr Davidson: Convener, I asked for your advice and I think that you have given it. I understand the situation in which you have been placed on the committee's behalf. As Elaine Thomson stated, this is a matter of principle that affects the whole Parliament. We are wasting time dealing with the inquiry regularly when it is going nowhere. There is other work that we could do. The budget process will be arduous for us all and we have a duty to ensure that the Finance Committee plays its part in it so that the other committees of the Parliament can play theirs. We should suspend the inquiry formally and report that to the Parliament through the convener.

Dr Simpson: If we concluded the inquiry now, our report would state that we were unable to ascertain some of the facts to our satisfaction. That is not very satisfactory. If we suspend the inquiry pending the determination of the protocol, that will give us an opportunity to see whether the protocol is adequate to allow the committee to obtain the information that we feel is necessary for the report.

Mr Raffan: I am not happy about suspending an investigation. I understood that there was going to be a delay and that a draft report would be prepared during the summer. I may be wrong about that, but at the end of June our work programme was pretty congested. It might help to break the logjam if our report said in no uncertain terms that we could not obtain all the information that we needed—that would highlight the issue.

I am not sure that we would gain much by suspending the inquiry. I have a horrid feeling that the protocol will end up being a vague document that contains a large number of subjective phrases that are open to different interpretations by the UK Government and by us. Waiting for it will simply delay matters further. In my view, we should go ahead with a report. We could issue it as a part 1 report and make it clear that, when further information becomes available, we will return to the issue and elaborate on the recommendations that we make.

10:30

Mr Davidson: On Keith Raffan's point, we should suspend rather than wind up the inquiry, because suspension keeps the issue live. We cannot walk away with sour grapes just because we did not get what we wanted. If we suspend the inquiry formally, explain the reason to Parliament and wait with an open mind for whatever protocol might emerge, we can pick up the issue any time that we choose. If we close the matter, we will have to go through the procedure again and put it back on the agenda at another date.

The Convener: I should point out that there is no commitment to issuing a protocol as yet, although we hope that that will happen.

Andrew Wilson: I agree with Keith Raffan's sentiments, but a suspension would at least allow the convener to report the situation to Parliament. The fact that a parliamentary committee's inquiry has had to be suspended for want of a protocol could be used to give weight to our case that a protocol should be issued. If we follow Keith Raffan's suggestion—to which I am, however, sympathetic—we will close the issue off. On balance, I side with David Davidson's suggestion.

The Convener: We have to decide how to proceed. Is there support for David Davidson's suggestion, which has been seconded by Andrew Wilson, that we suspend the inquiry, pending a protocol that clarifies the circumstances in which UK ministers will attend committees to give evidence? On the other hand, Keith Raffan has suggested that we produce a kind of part 1 report.

Mr Macintosh: When will we return to the inquiry? I would agree to a suspension of the inquiry, pending some information from the Presiding Officer or Parliament about progress on a protocol. However, we must be specific about the terms of the suspension. We should not be alarmist about the situation; we need to make some progress and, if necessary, stick a date on the matter.

The Convener: Your suggestion contains a contradiction—as soon as we have a deadline for lifting the suspension, we make it an issue. We have a heavy agenda later in the year with the budget and so on. I do not want to put a date on when the suspension should end; we should return to the inquiry as soon as that is practicable. Whether there is a protocol is out of the committee's hands and a deadline might just make things more difficult.

Mr Raffan: I agree with Ken Macintosh. I cannot support the suspension as it stands—it is too open-ended. We would not necessarily need to specify a date. For example, it is quite reasonable to say that we will return to the matter to review the position no later than the last meeting before the Christmas recess. If we do not do that, the matter is left completely open-ended.

The Convener: I think that we will have to take a vote on the matter.

Rhoda Grant (Highlands and Islands) (Lab): Convener, you should write to the Presiding Officer saying that we want a protocol and asking him to follow the matter up. He will respond and keep us up to date on any progress. In that way, the matter will be updated regularly without the committee having to put the inquiry on its agenda. We will make the decision about the inquiry when the information comes. Sticking dates on such matters is not all that helpful.

The Convener: I want to move to a decision now. David Davidson has made a proposal, which has been seconded by Andrew Wilson, that we suspend the inquiry without specifying a date for lifting the suspension. On the other hand, Keith Raffan has suggested that we include a date for lifting the suspension—that suggestion is backed by Ken Macintosh.

The question is, that the committee agrees that the terms of the suspension of the inquiry into European structural funds include a date for lifting that suspension.

FOR

Macintosh, Mr Kenneth (Eastwood) (Lab)
Raffan, Mr Keith (Mid Scotland and Fife) (LD)

AGAINST

Davidson, Mr David (North-East Scotland) (Con)
Grant, Rhoda (Highlands and Islands) (Lab)
Simpson, Dr Richard (Ochil) (Lab)
Thomson, Elaine (Aberdeen North) (Lab)
Watson, Mike (Glasgow Cathcart) (Lab)
Wilson, Andrew (Central Scotland) (SNP)

The Convener: The result of the division is: For 2, Against 5, Abstentions 0.

Motion disagreed to.

The Convener: The committee has agreed to suspend its inquiry into European structural funds, but not to include a date for lifting that suspension within the terms of the suspension.

It is regrettable that we have had to spend the first 35 minutes of the meeting on that issue; however, it sums up the rather unsteady progress of the inquiry.

Resource Accounting and Budgeting

The Convener: We move now to agenda item 3. I apologise for keeping Irvine Lapsley and Brian Ashcroft waiting during the previous item.

Subsequent to our meeting last week, Professor Lapsley has prepared a briefing paper on resource accounting and budgeting. It is unlikely that members have had an opportunity to read the paper and it might be helpful for Professor Lapsley to talk us through it.

Professor Irvine Lapsley (Adviser): This paper follows our very useful meeting with Dr Collings and Mr Macdonald of the Scottish Executive last week. The paper is not definitive; it simply maps some of the underlying principles of financial management and the key elements and issues around RAB that the committee might want to address.

Four principles underpin Scottish Executive and Treasury financial management. First, there is the intention to move closer to the private sector without achieving strict comparability. There are fundamental distinctions between public sector and private sector practices, such as the function of the assets and greater complexity on issues of public accountability in the public sector. Secondly, there is the golden rule, which involves financing long-term projects with long-term sources of finance. The final two principles are the intention to match outputs to inputs and to invest for sustainable output.

Although no one will disagree with those four principles, I should point out the limits on getting closer to private sector practice. There are also issues about the golden rule, which I shall revisit later. It is desirable to match outputs to inputs, because that shifts us away from the public sector's traditional focus of examining only inputs. However, we should recognise that the system is being developed and that there are problems with measuring outputs in public services. Nevertheless, we cannot advance unless something is done, so it is important to make the effort. RAB-type information should provide much more refined measures and information for finding out whether investment is achieving sustainable output.

Part 2 of the paper focuses on the key elements of RAB. First, the RAB system recognises continuing benefits that can flow from assets; it goes beyond the convention of considering cash investment in a given year as the only way to achieve visibility for assets. Historically, assets disappeared, effectively, from financial information after one year. That is clearly misleading and it will stop.

We also have a sharper definition of expenditure that includes commitments and liabilities. There is a definite and helpful attempt to link consumption of resources and flow of funds to resource usage in specified time periods. Finally, we have a framework now that links RAB analysis with objectives and outcomes.

Although all that is highly desirable and should prove beneficial, the system raises issues that the committee might wish to consider, especially the continuing costs of implementation, valuations, revaluations and getting accurate information. The committee might also wish to pursue issues about the robustness of the numbers that are generated, because—as we discussed last week—there are different bases of valuation for different financial scenarios. Shifting from one scenario to the other can have implications. For example, the decision to dispose of a principal asset can have financial consequences. The paper also flags up the major issue of pension liabilities, which has not been completely addressed.

Although the finance officers from the Scottish Executive gave a useful presentation, they did not dwell on the framework, but looked more at how the numbers were constructed. However, we should not lose sight of the fact that the framework is crucial to the exercise of accountability.

We have capital charging now. The cost of capital has been set at 6 per cent; however, that is a periodic figure that is generated by the Treasury and shows the marginal return on displacing a project in the private sector, with a depreciation charge included. We have information now that lets public service managers know that their capital is not a free good, but we need to address some important issues about interpreting what happens.

In summing up, I will try to draw some key issues together. First, does improving the information result in more effective and transparent financial management? For example, it was presented to us that we will deal initially with plans that are neutral in their fiscal implications. However, the intention that is behind the use of RAB is that things should be changed. RAB will change the perceptions and actions of key managers, who will then change their financial management accordingly. The Finance Committee should examine important issues such as the trade-offs between revenue and capital, especially in the big spending departments such as roads, health and education, where such trade-offs might have significant consequences. Managers will have to look hard at the complete set of assets that are at their disposal—human resources and physical assets such as buildings and infrastructure.

Secondly, we must consider issues about governmental accounting. There is a clear and laudable attempt to provide a more comprehensive picture of expenditure in the public sector and we now have a far more precise definition of expenditure on public corporations that includes both their capital spend and running costs.

Thirdly, the committee has also discussed local government accounting issues such as subsidiarity and different practices that have a similar cost-of-capital approach, but which are more notional than substantive. The move to more complete convergence on how we account will have important fiscal implications, such as potential increases in taxation and social housing rents.

The fourth key issue is the fact that RAB is about improving the visibility and transparency of financial information, which I am sure the committee agrees with. However, how do such developments sit with the former private finance initiative and new public-private partnership schemes? Such schemes could result in off-balance-sheet reporting of assets and a reduction in the quantum of principal assets of public sector institutions. A policy development that requires more transparency and openness sits side by side with a policy that means that we might lose sight of some assets.

The fifth point is that RAB might result in more accurate policies. For example, we mentioned greater visibility of the capital costs of maintaining roads, which raises all sorts of possibilities about cost recovery, pricing and charging or considering the costs of the road network vis-à-vis other forms of transport. Such information should inform debates and benefit policy makers.

Finally, I want to mention the sustainability of the golden rule. I should apologise for the cryptic note on that in the paper, but all it says is that the golden rule is entirely prudent and sensible. It makes sense to borrow for long-term capital, but—on the other hand—it is financially disastrous to borrow for revenue expenditure. However, there is an issue about financing capital from revenue, which happens in the private sector and might prove to be a pressure point for public sector institutions. Such institutions might feel constrained about the funds that they have available for capital expenditure and might be steered towards PFI/PPP-type schemes that they might find expensive. That would mean pressure to raise rates, charges and taxes, which is very important to the committee in the context of wider policy implications.

I apologise for the brevity of my paper, but it was produced at high speed, as members will see from one or two typographical errors.

10:45

Mr Davidson: I wish to pick up on point [3](6) of Professor Lapsley's note, document FI/00/22/4—I was able to follow the flow of thinking as indicated by the arrows. Will the approval of revenue for capital use put pressure on some of the public bodies—councils and so on—to carry out a short-term exercise, which would mean running into long-term debt management difficulties?

Professor Lapsley: That depends. There is no optimal gearing level—I refer to the relationship between the amount of debt and the amount of equity for public sector institutions. There is not a well-developed rule of thumb about what the proportions of that should be.

Financial managers who manage services are subject to imperatives that might be entirely beyond their control, for example European Community legislation. That drives them to make changes that require capital and they might be forced to take a hard look at how they can fund that. Private finance initiative and public-private schemes might not cover all the necessary funds. The obvious recourse for financial managers is for them to consider how they can increase charges.

That is simply the pattern that I suggest members might wish to observe and consider carefully.

Andrew Wilson: Professor Lapsley's paper is useful and gets us thinking about some of the issues. Those of us who attended the presentation last week realise that there is a great deal to resource accounting and budgeting. We will need to think carefully about whether we hold an inquiry or commission research.

One issue that is not raised in the paper is the implications for our relationship with the Treasury through the Barnett formula and how that feeds into this new system of accounting. Last week, Peter Collings said that RAB was set up to be neutral in terms of assessment of assets, their age and the requirement for replacement. I am sure that that is as it should be, but I wonder how we can monitor that to ensure that our position is protected. It strikes me that there are attendant upside and downside risks in the initial set-up of resource accounting and budgeting. We could end up gaining, but could just as easily end up losing significantly.

Why do you see RAB pushing public sector agencies towards public-private-partnership or off-balance-sheet financing?

Professor Lapsley: There are two issues. First, it is unfortunate that one of the most fundamental changes to governmental accounting in 140 years coincides with a change in the Barnett formula allocations. It is therefore harder to detect what is happening and some careful monitoring is required.

Secondly, under the prudence rule, there is a directive to public sector institutions to go for the best package that they can put together, which has to be the best comparator to the private sector alternative. Clearly, the tendency is towards PPP schemes and PFI-type schemes.

Running costs might be higher. Organisations' initial expenses might be lower, because they will have an entire package put together for them, but they may as a consequence have to revisit their approach. It depends on the nature of the scheme. A PPP scheme might embrace part of an organisation's capital stock—possibly the principal capital stock—but not all of it. However, public sector institutions need other capital and other forms of equipment.

There is an issue about how we see such schemes being used. If we view them as being used for essential equipment to deliver a service that is consumed relatively rapidly, that is almost a form of private sector borrowing. If we view them as being about the delivery of substantive and principal assets, that gives rise to questions about continuity. I suspect that financial managers in public sector institutions might have to consider carefully other means. The presumption that financial managers can add charges assumes that they all do so. However, only certain institutions do.

Professor Brian Ashcroft (Adviser): One important point to which Professor Lapsley has just alluded is that resource accounting and budgeting means that individual managers have, effectively, to pay for the opportunity cost of capital. The logic of that must be that there will be a degree of substitution from capital to revenue.

Previously, financial managers will not have had to meet the opportunity cost of capital. It is therefore likely that the next best alternatives will consist of revenue schemes to finance that capital—perhaps PFI. Leasing and other opportunities for smaller forms of capital equipment would be more likely to enter the frame. Clearly, there will be some impact on the balance of public expenditure, because the right price signals are now being put in place.

Mr Davidson: I do not doubt that there will be such a tendency in some services that use expensive equipment that has a short shelf life—due to technology change or due to the equipment simply wearing out. Are you suggesting that two forms of thinking will be required—one being short-term asset management and the other being long-term asset management?

Professor Ashcroft: No. One aspect of RAB is the inclusion of the opportunity cost of capital in the decision process. When they spent capital previously, managers would have tended not to do that—displacement in the private sector was not included. That introduces a new set of pricing rules, which will mean a switch towards revenue expenditure. To the extent that the capital project is bigger, the opportunity cost is much greater, so the substitution effect is also much greater.

Mr Davidson: Is that because of opportunity costs?

Professor Ashcroft: Yes.

Mr Davidson: Will there be a tendency among agencies—roads departments, for example—to seek to reduce the current asset value before getting into the matter of a notional cost? That would upset the balance of the asset base that was being negotiated around.

Professor Ashcroft: That might be the case—to the extent that a user cost is charged for existing assets. What I do not understand—I have to be honest—is the extent to which the notional costs buy, in terms of expenditures. If those costs are included in budgets, managers can make decisions, but there is no cash outlay. What happens to that cash?

Professor Lapsley: The crucial factor is how robust the numbers are. Dr Collings said—I think he used the adjective "soft", although I may be misquoting him—that it is partly a matter of the system's novelty. The system is in its infancy. The numbers might not be as robust as we would like and we should consider carefully the consequences of that.

If financial managers are forced into making trade-offs between revenue and capital and if the capital numbers are not as hard as we would like, erroneous decisions could be made. We are in a developmental phase—the situation is still changing and developing. It is still new.

The Convener: Professor Lapsley mentioned the sustainability of the golden rule. I am still not clear about that: the golden rule is not a new concept, so why would resource accounting and budgeting make the golden rule potentially unsustainable?

Professor Lapsley: I just raised the question. I cannot say definitively what will happen, but I would say that RAB makes everything much more explicit for managers working within the system. If managers have some freedom, and if that lies in charging prices for services such as buses or rents for housing, they must be tempted, when looking at the numbers and trying to trade off capital and revenue, to try to raise revenue to offset the additional capital costs that are introduced.

Not all managers have such freedom—I am

thinking of hospital expenditure, for example—but certain services might allow for it. There is an issue over how high the numbers would have to go before there would be some relaxation.

When we go back to the beginning, it is a question of moving closer to—but not being the same as—private-sector practice. In the private sector, lots of institutions, organisations and successful companies generate funds through pricing and plough them back into capital expenditure. That is not an unusual form of finance. Managers will make use of debt and raise funds on the capital markets, but if they have funds from successful investment they will also use them for capital spend. That highlights the extent of public sector managers' freedom to do the same.

Andrew Wilson: My question is on a separate topic, but it is related to what has been said about the relationship with the funding mechanism and blocking formula. Can you clarify whether I am correct in thinking that this raises problems? We have a stock of capital in the public sector in Scotland that is assessed for the first year. An accounting mechanism is then set up so that capital charges are applied to the overall stock of capital. In the future, changes to that stream or initial chunk of capital charging will be made through the Barnett formula, so that if changes occur in the UK as a whole we get a set percentage share of that.

That leads to the question: is our stock greater or smaller than that of the rest of the UK and do we gain or lose through that funding mechanism? Is the stock older or younger—which will determine whether a replacement will come more quickly or more slowly? The updating is carried out through a population mechanism. That does not strike me as sensible.

Professor Lapsley: That is a fundamental question. There is an issue about the vintage of the stock that we in Scotland have at our disposal, and about its pattern, disposition and the extent to which it relates to the situation—in other words, how sharp the numbers are.

I suspect that there will also be unevenness in England. If we consider the attempts to achieve equalisation in the health service, real disparities remain despite the best efforts of policymakers to achieve equivalence over five decades.

The continuing funding may not be sufficient to fund the existing asset base; it may be more a matter of hard decisions being made on revenue spent and on the amount of money coming in to service and maintain the assets. The whole thing might be put into sharper relief.

It would be interesting to see some comparative information on the vintage, structure and capacity of our assets vis-à-vis England and other regions.

Dr Simpson: Correct me if I am wrong, but it seems to me that there could be a perverse incentive inside the system. In the health service, the object has been to tell health boards that if they are holding assets they are not using they should dispose of them, but if those assets are disposed of and the situation becomes real—not just something being dealt with as an accounting matter—that will affect the distribution of funds to a devolved Scotland.

Professor Lapsley: What you have described is an effect of the RAB system. When we met last week, you may recall that there was discussion of things being neutral. The reality is that the intention of the new information is to change things. What you have talked about is one example of that.

We would expect that, two or three years into the operation of the system, managers might reduce the capital at their disposal. That might be a perfectly prudent thing to do if they have surplus assets that are not being used and which could be used better. It may make perfect sense. If they are forced to do so, however, and if they have to procure other facilities which do not deliver the same level of service, there is an issue about how sensible that is. That is the perverse element.

11:00

Dr Simpson: We should try—because health boards have been doing it for a considerable time—to get some health finance managers to give us some examples of how RAB has driven decisions. That would give us specific examples and might allow us to be clearer about how RAB works.

The other area that I want to touch on is pension liabilities, because there has been a lot of concern and many disputes—for example with the transfer of pension arrangements from the public sector to the private sector in respect of transport, and issues over miners' pensions. Over the past year, I have been concerned by what happens to the capital assets and values of these nominal pension schemes. How could one start to unpack the effect of RAB? I am not asking you to do that today. How RAB would affect, or would have affected, decisions could be part of a separate briefing note.

Professor Lapsley: I have two observations. First, your suggestion that the committee meet finance managers in the national health service and address these issues as experienced by them is superb. We would quickly get to the heart of the issues and the consequences of having RAB-type accounting systems, which would be beneficial.

Secondly, it strikes me that pensions is something that people want to talk about rather than do something about, because the implications are severe in terms of recognition of the extent of liability. If you had a full-blown RAB system, you would recognise pension liability and the assets needed to deliver it. There could be significant implications for the public sector. Dr Peter Collings said that for the pensions in the annually managed expenditure, the implications could be very significant.

Andrew Wilson: Will they be transferred?

Professor Lapsley: If they are transferred, the effect would be more than neutral, but we would have to look hard at the basis of pension funding, which is a huge issue in its own right. There is an issue about how that sits with the rest of the UK, but in terms of public services there is a big issue about recognition of liability.

The Convener: It strikes me that we are getting into detailed areas now. After last week's briefing there was a feeling that this issue might merit wider consideration, and perhaps even an inquiry. How do members feel about that? Andrew Wilson more or less signified that it might be a good idea. When we get into areas such as pensions there is quite a bit of information that we need. Richard Simpson mentioned practice in the health service that we might learn from. How do members feel?

Andrew Wilson: There are several issues, which both advisers have raised, that we have to address. It is our job and duty to look at them in detail. Having an eye on the implications for the incentives in our public services is a big issue. My major concern relates to more and more coming into the Scottish block and Barnett formula arrangements and the implications. This merits our attention. It has to, but what happens when we do not get any information? We require information. Let us commence our work, but it will be difficult.

Mr Davidson: As we go through this process I am thinking about the comments that were made at a cross-party meeting that I had with Aberdeenshire Council. If we are looking at rural councils, which have high infrastructure assets and a low population base, will the roll-out of RAB skew tremendously the local government finance settlement? I do not mean for Aberdeenshire Council in particular, but for councils in general. Account has to be taken of this issue.

As is obvious, RAB will not be introduced tomorrow, if that is when the Minister for Finance comments on it, but if you look at a valuation of assets that have traditionally been held by councils, such as assets that have been inherited from previous regional councils, you will find that there is a huge base of buildings that have been divided up on a geographic basis and which councils cannot do much with. RAB could be a tremendous strain on the asset base of less populous councils. How do we deal with that? Is it an issue for the Scottish Executive? Should we flag up that the Executive should come back to us with a view before we try to do anything, because there is a limit to how much work we can do on this?

Professor Lapsley: The problem is more with health than with local government because local government is, to some extent, at one remove. It has its own system of dealing with capital and it has figures that look like RAB figures, but it has been astute in that they are neutral. They are really management information rather than figures that impact on tax and funding levels. So health is the one area that is locked in to the system. If you take David Davidson's interesting example of a sparse population with assets—hospitals, for example—you have a direct comparator. That is where there is a bigger problem.

Professor Ashcroft: Transport is a factor that bears on what Andrew Wilson said. There are more miles of road per head of population in Scotland than in the rest of the UK. Once you bring such capital into the frame, there are implications for the Barnett formula which the Barnett formula does not deal with because it is based on population. In that sense, it is not neutral. The vintage and the scale of the capital stock in particular areas—and its implications for Barnett—should be looked at.

The Convener: Some of the points that David Davidson raised will, I presume, be dealt with by the Local Government Committee, which is considering local government finance. We will have to be careful not to cover the same ground, although we could benefit from the evidence that it takes. None the less, local government will have to feature in our inquiry.

Elaine Thomson: We could benefit from having a short inquiry. It is clear that there are a number of areas on which questions need to be asked. We need to understand properly the asset base of Scotland, whether it is properly valued, and the implications for health, transport and other areas. The issue of pension liabilities sounds a bit worrying. I support the idea that the committee has an inquiry. Richard Simpson's suggestion that we should bring in people who have been running under RAB for some time is good.

Professor Ashcroft: To illustrate a point, I draw attention to the table in annex 2, on capital charges. It is interesting that capital charges in transport outweigh revenue expenditure by 30 to 40 per cent, whereas in health, where capital charges are important—£205 million—they are a small fraction. It is clear that, in transport, they are crucial.

Professor Lapsley: If I may, I will speculate. Questions could be as follows. How do we recoup all this money? What about some cross-recovery schemes? What about road charging? It is about information and how it feeds in to decisions.

The Convener: I see that there is general approval that we undertake an inquiry. We are pretty well tied up until the end of the year, but Callum Thomson has suggested that we invite written evidence as soon as possible, with a view to taking oral evidence at the end of the year. It would be reasonable to think that we could do that in December, after the budget has been dealt with. Is that agreed?

Members *indicated agreement.*

The Convener: We will finalise a remit at the next meeting, although a number of the key issues that we would like to look at have helpfully been listed in Professor Lapsley's note to us today. I thank Professor Ashcroft and Professor Lapsley for their invaluable contribution.

We will now move into private session to consider agenda items 4 and 5.

11:09

Meeting continued in private until 11:36.

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ISBN 0 338 000003 ISSN 1467-0178