FINANCE COMMITTEE

Tuesday 11 December 2001
(*Morning*)

Session 1

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FINANCE COMMITTEE
27th Meeting 2001, Session 1

CONVENER

*Des McNulty (Clydebank and Milngavie) (Lab)

DEPUTY CONVENER

*Elaine Thomson (Aberdeen North) (Lab)

COMMITTEE MEMBERS

*Brian Adam (North-East Scotland) (SNP)
*Mr David Davidson (North-East Scotland) (Con)
Donald Gorrie (Central Scotland) (LD)
*Mr Tom McCabe (Hamilton South) (Lab)
*Alasdair Morgan (Galloway and Upper Nithsdale) (SNP)

*attended

WITNESSES

Professor Phillip Beaumont (University of Glasgow)
Martin Gaughan (Transport and General Workers Union)
Alex McLuckie (GMB Scotland)
Dave Watson (Unison Scotland)

ACTING CLERK TO THE COMMITTEE

David McGill

SENIOR ASSISTANT CLERK

Anne Peat

ASSISTANT CLERK

Gerald McInally

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 11 December 2001

(*Morning*)

[THE CONVENER *opened the meeting in private at 10:10*]

10:23

Meeting continued in public.

Items in Private

The Convener (Des McNulty): I welcome members of the press and public, and the witnesses from whom we shall take evidence under agenda item 3. Before that, item 2 is to invite the committee to agree to discuss in private item 4, which concerns an interim report from Norman Flynn on outcome budgeting, and item 5, which concerns witness expenses. Is that agreed?

Members *indicated agreement*.

Private Finance Initiative/Public-private Partnership Inquiry

The Convener: Item 3 is an evidence-taking session for our private finance initiative/public-private partnership inquiry. The four witnesses are all well kent faces. They are: Professor Phillip Beaumont, who is professor of employment relations at the University of Glasgow; Martin Gaughan, who is a regional officer of the Transport and General Workers Union; Alex McLuckie, who is senior organiser of GMB Scotland; and Dave Watson, who is the Scottish organiser of Unison Scotland. Welcome, gentlemen.

Increasingly, our practice has been to move away from hearing general opening statements. We have received some written evidence from each witness and my intention is to move straight to questions, unless the witnesses have something particular to say at the outset.

The general thrust of some of the arguments of advocates of PFI/PPP is that the public sector is inherently inefficient and that the discipline of the market is required to improve efficiency in the delivery of public services. For the record, do the trade union representatives agree with that?

Dave Watson (Unison Scotland): I shall not surprise the committee by saying that we do not agree with that statement. I want to focus on the two arguments that are given in favour of PFI/PPP: the value-for-money argument and the "what works" argument.

The simple fact is that PFI/PPP schemes cost more than schemes that use conventional borrowing. Even the city analysts Chantrey Vellacott—whose report I refer to in our written evidence—refer to the fact that PFIs cost £50 million more for every £1 billion of capital value. Every PFI scheme in Scotland that we have analysed—the obsessive secrecy that surrounds PFI schemes did not make that easy—has cost more than the project would have cost using conventional borrowing. The main elements of that higher cost come from the higher cost of borrowing in the private sector and from the fact that the private sector must—quite reasonably for the private sector—build in an element of profit.

How can it be possible that PFI schemes, which cost more, are allowed to go ahead despite the public sector comparator, or PSC, test? I notice that the committee has, after hearing previous evidence, given consideration to the PSC and understands what it means. As I show in our written evidence, the problem is that the PSC uses a number of refining processes, which is a polite way of saying that the numbers are jiggled to make the public sector comparator appear to be more expensive than the PFI option.

In my written evidence, I have listed those refining processes, of which the main method is risk transfer. The simple fact is that if there was as much risk as has been calculated for some PFI schemes, the lenders would not touch the schemes with a bargepole. Banks are not in the business of lending money against risk. If they lend against risk, they do so with a heavy premium. That is the position on risk transfer.

If we compare the areas in which there is growth in the number of PFI schemes with the areas in which there is no growth, we notice that growth exists where capital controls are tightest and decline exists in areas where capital controls are weakening. Hence, we have a flood of PFI schools schemes because local authorities are constrained by section 94 consents, but there is a decline in the number of PFI schemes in the health and water sectors, where the capital constraints are not as great.

PFI schemes are ring-fenced. That means that either services must first be cut to deliver the scheme or, after costs start to grow, other services must be cut because the PFI schemes cannot be cut. That deals with the value-for-money argument.

The second argument in favour of PFI revolves around the “what works” argument. Some politicians and others say that all that matters is what works. We are told that PFI schemes deliver better than conventional schemes do. However, that that is not the case is shown by the English experience, which I document in our written submission and in the additional documents that I have lodged with the clerk. Some of Scotland’s first big PFI schemes have started only recently, but the same problems have been experienced: problems with design; problems with late delivery; and problems over inability to deliver on what was promised.

In fairness, I accept that similar problems could happen in schemes that are funded by conventional borrowing but, to be frank, the method of borrowing the money makes no difference to whether a large capital project goes right or wrong. All sorts of factors are involved, such as acts of God, the weather and bad client design. The way in which a scheme is financed is entirely irrelevant to the process.

PFI is not a better means of delivery. Apart from the other sideline issues that we have addressed in our written submission, PFI is more expensive.

The Convener: I want to pick up on two or three aspects. Notwithstanding the finance issue, is there any evidence to show that set objectives, such as the construction element, are delivered more poorly or better under PFI?

10:30

Dave Watson: No. Nobody has produced even a solitary piece of evidence that suggests that a building has been built better because the money was borrowed using different means. There are many reasons for that. We have highlighted many failures of big PFI schemes but, in fairness, those failures have nothing to do with money, but rather relate to design factors and client issues.

The Convener: They relate also to management.

Dave Watson: Yes.

The Convener: Your paper contains some statements for which I would like to know the evidence. It states:

> “Scotland is the biggest user of PFI with almost half the UK total estimated capital spend.”

Do you have evidence to support that?

Dave Watson: The evidence comes from last year’s red book.

The Convener: It is interesting to have that quantified.

Dave Watson: That statement concerns capital value, not revenue. A problem in Scotland is that we can identify only the capital value of PFI schemes. Calculating the real cost of PFI schemes is much more difficult.

The Convener: Do you acknowledge that any efficiency gains can be obtained from PFIs and PPPs?

Dave Watson: No; we have found no efficiency gains. However, part of the difficulty—I hope that the committee will address this—is the obsessive secrecy that exists about such schemes. I have analysed many PFI schemes in Scotland, but only those for which we could obtain copies of the relevant documents. Public authorities have been highly reluctant to release details about many big schemes.

When the June 1999 rules on greater openness forced authorities to release details, the authorities produced sanitised business cases. The Glasgow schools PFI was a classic example of that; a copy of the business case was leaked, which we analysed and published. However, the business case was sanitised—it contained no annexes or hard figures. The risk transfer figure for that scheme was quoted as £70 million, but not one figure in the full business case backed that up. If that £70 million had not been counted, the public sector scheme was £35 million cheaper than the PFI.

The Convener: That is all in your evidence.

Alasdair Morgan (Galloway and Upper Nithsdale) (SNP): It has been argued to us that an advantage of PFIs is that they force clients to get their specifications correct and to make up their minds finally, whereas conventional procurement allows clients to continue to change their minds as a project proceeds. It is expensive to do that when a contractor has a contract. What do you say to that argument?

Dave Watson: Proper capital procurement processes should be in place in the public sector. There is no reason why the public sector cannot organise a conventionally funded capital project in exactly the same way as a PFI would be organised. Often, companies that are involved in a PFI say that PFIs are better because built into them is better design. For example, they say that they insulate buildings better so that energy costs might be cheaper later. That argument concerns the way in which capital projects are provided. Exactly the same measure could be undertaken in a public procurement arrangement. The only difference would be in the way in which the money was borrowed.

The committee should remember that most public sector capital schemes are undertaken by private sector companies. Huge national health service or local authority building companies do not exist. The same building contractors would undertake the schemes under the conventional process.

Mr Tom McCabe (Hamilton South) (Lab): That point is interesting. In 2001, why has not the public sector developed processes that make conventional procurement of projects as efficient?

Dave Watson: In recent years, so much effort and officer time has been spent on PFIs that such developments have not been allowed to take place. The big NHS and local authority capital manuals, which set out the processes that officers tend to follow, have not been revised for many years. That is because all the resources that have been available—including a huge amount of uncosted time and millions of pounds for outside advisers—have been used to develop PFI schemes. The processes to which Tom McCabe refers need development. If the public sector had a more rigorous capital regime, we could improve those systems no end.

Brian Adam (North-East Scotland) (SNP): North of the border, a substantial amount of public procurement is done by PFI/PPP, but less is done that way south of the border. Does evidence from south of the border show that the lessons of improvements in public procurement are being learned?

Dave Watson: Some evidence exists, which has—ironically—been driven largely by members' counterparts at Westminster. A good example of that is refinancing. The National Audit Office produced a report on the refinancing of the prison contract at Fazakerley that showed that private companies were simply refinancing risk and making huge profits. As a result of the work of the Finance Committee's equivalents in Westminster the rules changed so that the benefits of that refinancing are now shared between the public and private sectors. However, it was a year after the NAO's report was produced before the Treasury changed the rules. We are always behind the game in such changes.

Brian Adam: I am talking about refinements from the PFI/PPP process that have been applied when the public procurement route has been decided on. Is there any evidence that, when the public sector does not commit to PFI/PPP, the public procurement route has been improved through refinements that resulted from the PFI/PPP process?

Dave Watson: I do not work in England, so I do not have up-to-date evidence of that. Some changes have been made because of the greater availability of conventional capital as a result of the current round of public expenditure.

One reason for cuts in conventional capital programmes is that a programme starts with a budget but, as Mr Morgan said, clients ask for additional items. That requires cuts in other areas. If additional requirements were designed earlier, that problem would not exist.

Alex McLuckie (GMB Scotland): Difficulty is caused by the phrase “the only game in town”. Councils have had difficulty in comparing the traditional route with the PPP/PFI route because they have been told that PFI/PPP is the only game in town.

My council—Falkirk Council—was the first to enter into a PFI scheme for five secondary schools. A year previously, the council had produced a primary school on time and to high standards. In the press, the council said that it was a public authority that could deliver to a high standard against private sector competition. One year later, the council had to undertake a PFI, because that was the only game in town. If the council wanted new schools, it had to use a PFI. It would not be given the money for the conventional route.

Mr David Davidson (North-East Scotland) (Con): I will pick up some of Mr Watson's earlier comments about evidence against the PFI/PPP procurement system. Do you agree—in a way, you have already done so—that much of that evidence relates to many public sector clients not getting their acts together to design ahead? They design for the short term and, as Alasdair Morgan said, they then modify the contract.

Do you agree that, as academic evidence shows, some early schemes went awry because of a lack of initial design? It has been claimed that that is the fault of PFI, but it was a fault of the design of the schemes. Some academics in Scotland have argued strongly and produced evidence that suggests that additional costs went against the image of PFI/PPP. What is Unison's view of such evidence? It is important that the committee hears a balance of opinions on both routes and that we do not decide that one route is bad just because of the sector from which it comes. Is the initial set-up—the system of designing—fundamentally at fault? If so, how can that be remedied?

Dave Watson: It is, particularly when PFIs are used, difficult to know the reason why there is significant growth in costs between the start of a project and its completion, because details on schemes are unavailable. I have debated the matter with academic colleagues who have also not seen the information. However, we know that scheme after scheme has started as X and ended as Y. That has usually involved great additional cost or a massive reduction in services. For example in hospital schemes, the average reduction in bed numbers between the time before a PFI scheme starts to its being finished is 31 per cent. A similar thing happened in the Glasgow schools scheme, in which there were reductions in the number of classrooms, swimming pools, gymnasiums, teaching areas and so on.

We know that the costs of PFI schemes grow. I argue that there has not been a similar exponential growth in conventional capital schemes. However, to be fair, conventional schemes must be planned for the long term, taking into account revenue costs as well as capital costs. In the public sector, historically we have separated capital and revenue, to the extent that they have been regarded as two different budgets. We have adopted a lot of artificial systems to take account of that.

One of the reasons why there have been problems with school PFI schemes is that people believe—wrongly, according to the Treasury and everyone else—that they must get the scheme off balance sheet. That is because of the way in which departmental capital and revenue budgets are organised.

All those issues are, if you like, artificial; the real issue is that we must design for what is required. We must work out both the revenue and the capital implications and we must almost ignore where the money is coming from. Good design and good project management are important irrespective of who provides the money.

Mr Davidson: The committee is taking evidence in an effort to pick out all the flaws and benefits of PFI and PPP schemes. We hope that we are doing so on a fairly neutral basis. The first page of your document suggests that you are agin such schemes, just because you are agin them. I accept that you give evidence for that view, but we are looking for remedies and not only evidence that indicts. How should such schemes be reviewed?

Dave Watson: The starting point is to say, "The schemes do not work—let's do something different." We want to deal with the issue of the alleged off-balance-sheet treatment. In Scotland and throughout the UK there still exists a problem of advice being given to public bodies to the effect that a scheme will not work or will not be approved unless it is taken off balance sheet. Despite what the Treasury has said, local officials are being told that schemes must be taken off balance sheet. That is quite wrong.

Staff transfer is a big issue. It has not been required since June 1999, but there is still a problem of incorrect advice being given to local officials on the issue.

The third issue that we would want to deal with is the need to identify capital expenditure and to revise capital mechanisms to build in best practice in the delivery of conventional capital schemes. The way forward is to fund schemes by conventional capital means and then to build in appropriate disciplines so that schemes can be delivered to the original design and on time.

Brian Adam: It is a fairly serious allegation to suggest that officials are giving advice that is contrary to Treasury advice. Do you have specific evidence of that? Could you at least point the committee in the direction of specific contracts in which that has been the case, so that we can investigate further?

Alex McLuckie: Glasgow City Council stated wrongly that there must be a significant transfer of staff to the private sector contractor. That was included in a document entitled "Public Service, Private Finance" by University College London's school of public policy.

Government policy, however, is that the transfer of staff to the private sector should be subject to a separate value-for-money appraisal and that cost savings should not be achieved through worsening the terms and conditions of current and future staff. Schemes that involve a reduction in the number of staff should be compared only with public sector comparators that have also been adjusted to reduce staff numbers. That information is from a document that gives an update of the first operational school contract and which can be found on the www.4ps.co.uk website.

North Lanarkshire Council made an announcement last month in a document that I have here, which is entitled "Education 2010". Our officials have been involved in that. The first working paper was drawn up on 14 September 2001 and it states:

"The partner also owns, operates and maintains the facility for a period of approximately 25 years. Each PPP project involves the negotiating the sharing of risks, responsibility and power between the public and private sector and these include … the provision of support and community services."

Later in the same document is report 4 from 18 September of the member-officer working group. That report says that part of any public-private partnership project is that the private partners provide a number of services in new build or refurbished buildings over the lifetime of the contracts. Services that are normally included in schools PPP projects include building and grounds maintenance, cleaning, waste management, caretaking, site supervision, security, catering and cleaning of buildings.

That information is in a document that was put on the table last year. That says to our officials that, for us to get funding, there must be risk transfer. That means transfer of employees in catering and cleaning, who are part-time women workers.

10:45

Alasdair Morgan: I want to pick up on the points about getting stuff off balance sheet. Providing that the Treasury sticks to the definition of the public sector borrowing requirement, a time must come when you want to get things off the balance sheet. Surely there are ways of getting things off balance sheet without using PFIs. For example, we have heard about trusts for the London underground. Trusts would be one alternative.

Dave Watson: There are ways of keeping things off balance sheet, but they are extremely difficult. We are talking about Treasury rules and there is obviously a problem for us in Scotland in dealing with such matters. In various documents, we have spoken about other ways in which the Treasury could do things—even if we did not have the favourable capital balances that we have at the moment. We could easily fund all PFI projects from the surplus that the Chancellor has in his current budget plans. PFI is therefore entirely unnecessary, even if a project needs to be off balance sheet.

We have also demonstrated ways in which the Treasury could change accounting rules, especially if we adopted the general government financial deficit as an alternative model. That would create a huge amount of headroom for capital spend.

The problem that risk transfer causes for us is that officials believe that they must transfer staff to achieve it, as Alex McLuckie pointed out. However, the Treasury has said clearly that that is not the case. It has also said that schemes do not have to go off balance sheet to get approval; however, I ask committee members to ask officials how many on-balance-sheet school schemes have been approved. Non-school schemes are off balance sheet, because of the scope that they are allowed by their capital consents. Local government officials have the problem that, if they put a scheme on balance sheet, it counts against their capital consents.

It is ironic that Alex McLuckie used the phrase "the only game in town". I smile every time a leader of a council says that or every time I see it plastered all over the newspapers. "We have to have PFI because it's the only game in town," they say. There was a good example of that in North Lanarkshire. However, if North Lanarkshire Council had put in a bid for a scheme to the Scottish Executive finance and central services department at Victoria Quay on the basis that PFI was the only game in town it would have been thrown out, because that is not allowed. There is a good deal of misunderstanding. To be fair to local authorities—especially to councillors on committees—the issues are enormously complex. It is very complicated to explain the figures that relate to a PFI scheme and to explain concepts such as net present value, net present cost and so on, as distinct from hard cash. It is difficult to explain what off balance sheet, risk transfer and staff transfer mean. Those things are not always explained clearly to councillors in committee when they must make decisions.

The Convener: We have heard in evidence that the higher cost of private borrowing is not a significant factor in terms of the relative costs of PFI and public sector schemes. You say that PFIs are necessarily more expensive. What are the main factors in that?

Dave Watson: The cost of borrowing is not hugely significant, because the cost of borrowing for PFI schemes has decreased in recent years. We must ask ourselves why. It has decreased because all the risks remain in the public sector. The most bizarre rule of all is highlighted in our submission. If a PFI contractor defaults completely on a scheme and the local authority or health board must replace the contractor, the contractor must still be compensated. That is crazy—in a conventional scheme, a penalty would be levied on the contractor. That is not the case in PFI schemes. As a result, bankers are bound to take the view that their money is pretty safe. If they are guaranteed to get their money back whatever happens, borrowers will get a fairly reasonable credit rating. The difference in cost is not huge, but it still exists and it still adds up to many millions of pounds for big schemes.

The Convener: You are saying that, because the transfer of risk to the private sector is fairly insignificant, the risk remains within the public sector.

Dave Watson: That is right.

The Convener: So it is secure borrowing.

Dave Watson: Yes, it is secure borrowing. In addition, a rate of return still has to be built in. You will remember having a quick look at water PFI schemes in your previous existence as a member of the Transport and the Environment Committee, and you will recall the sort of figures that were quoted in relation to the finances of water schemes. A return of 18 per cent on capital employed was discussed—I wish that I could get an 18 per cent return on my savings, tax free or not, but I am afraid that I cannot. Such schemes are therefore still fairly profitable areas, and that profit payment is a cost, which clearly does not apply to the public sector or public procurement.

The Convener: However, when we considered the water schemes, those figures were not borne out.

Dave Watson: You will recall that I told the Transport and the Environment Committee that, as it did not have the opportunity to do an analysis of a scheme, it was a bit difficult to know about such figures. Given that no water scheme has ever been published, it is hard to know how the financial criteria of such schemes are worked out.

The Convener: You said that such projects could be done equally well under public sector procurement. I am thinking in particular of small local authorities. Do they have the resources effectively to plan and co-ordinate a major venture such as a significant schools procurement project? Even the larger authorities have difficulty identifying the correct specification, in both PFI and conventional schemes. Many problems have been associated with poor specification at the outset affecting the way in which projects can be carried through. How do you envisage the public sector dealing with such problems as a lack of expertise or a lack of resources in planning such major schemes?

Dave Watson: One of the lessons that are beginning to be learned from PFI schemes is that we should not constantly reinvent the wheel. I attended a meeting with the former Minister for Finance and Local Government not so long ago. I am aware that he initiated a project—on which I presume the officers who used to work under him are still working—to discuss rationalisation and the introduction of common standards to schemes throughout Scotland.

Some work was done on that down in England, through the pathfinder schemes. Some examples of such schemes exist in Scotland, including schemes for schools in Falkirk and Glasgow and a couple of the big national health service PFI schemes. The intention behind pathfinder schemes was to learn lessons and to produce standard documentation and so on. However, they have not really been developed. The problem was that most of the pathfinder schemes were not very typical—in fact, they were atypical in many ways.

Some lessons could still be learned. I mentioned capital manuals—many standard processes could be built in if they were developed across Scotland. Local authorities and health boards and so on could then pick them up as being standard arrangements and fit their local requirements around them.

Many of the contract-related and other elements do not need to be reinvented each time. Local authorities and other bodies need to decide how they need to design a particular facility to meet needs. We have never been precious about this; we have always recognised that, in some cases, the private sector might have some expertise in the areas concerned. In reality, however, if only one or two hospitals are built over an awfully long period, nobody will have the expertise at the end of that time.

The NHS used to have a building division, which contained all the experts in building hospitals we might want, including architects and engineers. The previous Government privatised that division and turned it into a company that bid for PFI projects but did not win as many contracts as it wanted. Now, some of those leading architects and engineers are designing oil rigs for the North sea instead of designing hospitals, which is where their expertise lay.

Expertise must be built up, but it can only be accumulated by doing. If it is decided that refurbishing Scotland's schools is a major issue—without any argument, that is an issue—relevant expertise is developed across Scotland and the appropriate documentation is built in. The local authorities are then approached and assigned that expertise; the local authorities add in the local element, which is not a huge task, and we end up developing good, well-qualified experts.

We used to have schemes involving standard-sized buildings for different functions. Off-the-shelf designs could be produced for the particular purpose. All that is being lost because the wheel is constantly being reinvented in the spurious chase for a bit of competition.

The Convener: That is not always disadvantageous, if we consider the schools that were built under the standard schemes—there are swings and roundabouts.

Dave Watson: That is true.

The Convener: Even you would not argue that the public sector is perfect. Assuming that the levels of employment and the skill mixes in the public sector could be made efficient, how could PFI/PPP improve on inefficiencies? How could PFI bring any benefit and improve the skill mix in the public sector—or do you think that PFI is entirely disadvantageous in that regard?

Dave Watson: There is no particular evidence that the skill mix in the private sector is any better than it is in the public sector. There are supposed to be value-for-money exercises on major PFI schemes, but those have never taken place. If you read the full business case presented for the Glasgow schools project, you will find that no such analysis took place. That is partly for the reason that Alex McLuckie identified: that officers mistakenly believed that that was not an issue.

If we consider the VFM exercises that have been carried out, it turns out that many of the lessons of competition, for example in relation to soft facilities management, have resulted in very similar skill mixes. It is hard to differentiate between the direct labour organisation and many private companies in the way in which they organise cleaning, catering and other arrangements. The difference is that in-house provision carries some flexibility, in that if changes have to be made, it is not then necessary to renegotiate the contract. The techniques are not vastly different.

The Convener: Let us suppose that we take PFI out of the equation—presumably, that is what you want to do. If we do not go down the route of PFI, how do we ensure that the public sector develops the required skills and expertise?

Alex McLuckie: That is already covered by the best-value legislation, under which continuous improvement is required. I believe that the final draft report on this matter gave the same seven criteria that had to be met under best value. We envisage those improvements continuing in the public sector.

I believe that the accounts commissioner produced a report last month, in which he examined whether we are making the progress on best value that we should be. In the main, that report gave a clean bill of health to what has happened so far.

I return to my earlier point about the mistaken belief that is held in some areas that staff have to transfer because of PFI. In considering how PFI affects staff issues, we have to take into account the fact that local government workers have given a lot of service in the public sector and will want to remain in the public sector. From some of the PFI schemes in which I have been involved, I recall some quite heated and robust debates involving local government employees who asked why they were being dumped after 30 years' service. That is not necessarily what had happened to them, but that is how they felt.

Given a fair wind, in-house provision could give value for money. The difficulty is that that is not being allowed, because of a mistaken belief that there must be a transfer of risk. Some new evidence is making matters worse in my view. In the last two PFI projects of which I am aware, the employees were asked whether they wanted to remain with the council or move. If they all choose to remain with the council, I do not quite see where the transfer of risk is.

On employees issues, we are also concerned about the provision of pensions. Another great concern of ours is the creation of a two-tier work force. One thing in the PFI scheme that I believe—

The Convener: We will come to specific questions on those issues.

11:00

Elaine Thomson (Aberdeen North) (Lab): Part of the answer to my question has probably been covered. PFI started under a different Government quite a long time ago, when compulsory competitive tendering was still in operation. Do you acknowledge that the situation has changed and that some PPP schemes that are being constructed and designed or have been rolled out are different from schemes that were originally rolled out? I understand that Unison has been involved in a number of schemes down south in which staff have remained in the public sector. Nevertheless, it was deemed that going ahead with those schemes on a PPP basis was still worth while for different and separate reasons.

Dave Watson: We should give credit for some changes that have been introduced. Members have probably worked out that there is much misunderstanding about PPP and PFI. There is a view that PPP is a new Labour spin on PFI, but it is not. PPP is a framework and PFI is one scheme within the overall PPP framework. PFI has particular rules. It is interesting that in Scotland, a shift is beginning away from PFI towards broader PPP schemes, which do not have such rigid rules. We must wait to see how that pans out. I hope that the shift has occurred because there is flexibility, but I suspect that it has happened because the same amount of scrutiny does not fall on a broader PPP scheme than on PFI schemes. The water industry is a good example—there are not the same rigours in respect of PFI schemes.

Some benefits have changed. The changes in accounting rules for PFI were important. In fairness, they were largely driven by the Accounting Standards Board, but nonetheless the Treasury eventually accepted its recommendations after a major battle. The changes meant that staff did not need to transfer to achieve the risk transfer. The Government also made a useful statement on the subject of off-balance-sheet and balance-sheet schemes and made it clear that one does not need to go off balance sheet in that area. There have therefore been technical issues. The Government is due credit for improvements in the construction of contracts, although I think that a lot more can be done. I hinted that we could do more in Scotland in that respect.

Those are important gains. Important gains have also been made in staffing. The Cabinet Office statement of guidance on staff transfers has been helpful in making it clear that staff do not have to transfer, but when they do, Transfer of Undertakings (Protection of Employment) Regulations will apply. Revisions of the TUPE regulations have been long-drawn-out and we are still at the consultation stage. Nonetheless, we are moving towards improvements. Alex McLuckie mentioned that the issue of pensions has been addressed. There must be at least broadly comparable pension schemes when staff transfer in those areas.

Those are important gains, but there are some shortfalls. There is Cabinet Office guidance and there are TUPE revisions, but there are still two-tier work forces post-transfer. Staff who transfer may be protected, but new starts are not. Workers are therefore on different terms and conditions and—most important—on different pension schemes. Those new starts are predominantly women and low-paid workers. In effect, PFI reinforces the low-pay cycle and a two-tier work force. The Equal Opportunities Commission and others have carried out work in that area.

Those are big issues. In Scotland, we need a comprehensive staffing framework for dealing with all types of PPPs, as distinct from only PFIs. Members may recall that, a couple of years ago, the then Minister for Health and Community Care announced a project on that issue and asked the Scottish Partnership Forum—which includes trade unions, trusts, boards and employers in the health service in Scotland—to produce a staffing framework for PPP schemes. The project was not simply to do with staff transfers; it started a consultation process to consider in detail how particular schemes are developed and, if staff transfer is involved—many schemes do not involve staff transfer and do not need to—a number of arrangements to ensure that there is not a two-tier work force.

I regret to say that, although the document made considerable progress within the health department, when it was passed around other Scottish Executive departments, progress was slow, to say the least. We drew that to the attention of the then Minister for Finance and indicated that it was about time that progress was made.

If a comprehensive staffing framework was in place, a number of staffing issues could be addressed constructively—we want to highlight that as a particular issue for the trade unions. The lack of progress says much. There should be a drive to bring the issue to a satisfactory conclusion.

The Convener: We will now move to industrial relations issues.

Brian Adam: Perhaps my questions will be particularly relevant for Professor Beaumont. What is the potential impact—perhaps the actual impact—of PFI/PPP on public sector industrial relations? If we continue down the PFI/PPP route, is it inevitable that there will be lower levels of employment and lower real wages in the public sector?

Professor Phillip Beaumont (University of Glasgow): Two aspects of industrial relations need to be distinguished—the procedural aspect and the substantive aspect.

On the procedural aspect, this is a highly unionised sector. If the current process continues, the unions will say that they have been told that PFI/PPP negotiations are the most important negotiations and that they are excluded from them, at least in the critical early stages—that is worrying. There is a concern that that will impact negatively on bargaining throughout the public sector in Scotland. In a sense, there will be adverse spillover effects if the unions are excluded from important negotiations. That could disrupt the relationship between unions and management in the public sector.

Implementation issues have been mentioned. If the design stage of the process is separated from the implementation stage and stakeholders and people who are making big decisions are kept separate, the implementation process will be flawed, almost by definition. The unions are right to say that there is a major inconsistency in the existing partnership arrangements in the Scottish health service, for example. There are potentially huge procedural issues.

There is also concern about the two-tier work force. A distinction is often made between folks who transfer over and new hires. It is particularly important that contracts are very long—25 to 30 years. An incentive can be built in to ensure that most employees will be late hires, who will not be covered. Any employer will say that co-operation, co-ordination and teamwork are extraordinarily difficult if people who are working alongside each other are on substantively different terms and conditions of employment. There will not be the same co-operation and co-ordination in such circumstances—that is a fairly natural human reaction.

Brian Adam: Is there any evidence of that happening? The practice does not simply relate to PFI/PPP—it existed as part of the CCT arrangements. Do you or the union representatives have any evidence of industrial relations being destroyed as a consequence of the type of change that you described?

Professor Beaumont: Do you mean as a result of the two-tier system?

Brian Adam: I mean as a result of there being new starts on poorer conditions and workers who are TUPE protected, even if that protection is somewhat inadequate. Is there evidence of poor industrial relations? Is the evidence about poor morale and poor standards anecdotal?

Professor Beaumont: In my replies to a number of questions, I will sound like a broken record. The zone is largely data free. It is extremely difficult to give evidence. There are many anecdotes and stories out there, but not a lot of hard, objective evidence. That is not surprising because the process is very new and these are early days. I cannot put my hand on my heart and say that there is a lot of firm evidence.

I think that one can make good a priori arguments for the likelihood of such co-ordination problems. One can consider parallel situations. There has been a huge concern about health and safety and whether accident rates would rise if there were greater use of contract labour. Some interesting work has been done on that. However, that is arguing through analogy. At the moment there is not much smoking-gun evidence that I can point you towards.

Brian Adam: CCT, which was the forerunner to PPP/PFI, was put in place in the mid-1980s. There must be some of way of assessing its impact.

Alex McLuckie: Professor Beaumont is right: we are at an early stage in relation to PFI and PPP schemes. Without doubt, new employees are coming in on inferior terms and conditions of employment—they get fewer public and annual holidays, are put on different pension schemes and have different sick-pay provisions and rates of pay. We are currently dealing with some of those issues in Glasgow and Falkirk.

The point was made that those are long-term arrangements. People who transfer might be comfortable in that their terms and conditions of employment are not affected and new people are coming into the workplace—perhaps they were long-term unemployed—who, for the moment, are simply happy to pick up a job and have money coming into their household. However, the difficulty is in the long term. Four or five years down the road, those people will start to question why they are being treated differently to others who are doing exactly the same job. They will ask why, if they are part of the team, they are treated differently from other members of the team.

At the moment, the trade unions do not have people beating a path to our door. However, I am sure that all the union representatives sitting here are aware that in the future, we will have to deal with that problem. It can be resolved, perhaps by the implementation of something like the fair wages regulations that we had in the past. It could be part of the contract that terms and conditions of employment will be governed by the relevant negotiations at a local level. There will be local variances.

Brian Adam: How has the introduction of CCT and PFI/PPP impacted on the nature of the relationship between the management and staff representatives? Traditionally, in the public sector, there has been national wages and conditions bargaining and local negotiations addressed different issues.

Alex McLuckie: It would be fair to say that there has been a lot of prodding of certain terms and conditions to see whether there are weakness and whether they can be changed. In relation to the Falkirk Council PFI scheme, we were challenged on at least 10 conditions of employment for janitors who transferred. The North Lanarkshire roads PPP has provoked an on-going argument about whether we should move away from local government terms and conditions towards the Construction Industry Joint Council terms and conditions of employment. There has been an attempt by the employers to move away from the national terms and conditions of employment. At the moment, it would be fair to say that we are trying to defend the current conditions of employment for our members.

Previously, our stewards were usually involved in issues outwith terms and conditions, such as disciplinary action and grievances, because the terms and conditions were negotiated centrally. Now, there is greater local involvement. However, that involvement relates to protecting terms and conditions of employment or trying to maintain the current terms and conditions.

11:15

Professor Beaumont: I have a couple of observations on CCT. The important element of CCT was the capacity for the in-house bid. Ironically, that encouraged two things: decentralised negotiations—one can argue whether that was good or bad—and closer working between the unions and local management. That was undoubtedly a factor in the relatively high win rate under CCT. One could argue that that was a substantial benefit at quite a difficult time.

If one considers the substantive impact of CCT, the productivity increase can be brought about in two ways: by pushing up the numerator, or pulling down the denominator. The evidence of the Institute of Public Policy Research suggested that the methods were very mixed—sometimes the numerator went up and sometimes the denominator went down. In cases where the denominator went down, one must ask seriously whether that was private sector innovation. I have a huge issue about labelling something innovative, with its very positive connotations, when it involves cutting terms and conditions of employment. I must be blunt and say that I do not regard that as cutting-edge innovation.

There were lessons to be learned from the CCT experience. At the moment there is a dearth of good work on public sector industrial relations. Perhaps the most alarming thing to come out of the recent Chartered Institute of Personnel and Development study was the suggestion that although there was not a huge sea change, several indicators were moving negatively. Perceptions of the quality of the working relationship between unions and management were that it was worsening.

Similarly, the ability of employees to trust the management in the public sector was tending downward. There were similar trends in the private sector. As a policy maker, I think it is clear that the movement is not in a positive direction.

Brian Adam: Is it not true that the most common consequence of CCT was that in-house bids won—whether in the local authority or the health service—but almost always at the expense of the total number of jobs and the package of pay and conditions? Although it is fair to say that local experience in producing a competitive bid was developed, the local management did not have a great deal of experience of dealing with national conditions. The trade unions did not have the experience either, because they were geared towards a totally different arrangement. Has that had a major impact?

The Convener: We are focusing on PFI as opposed to CCT. Do you think that PFI/PPP has accelerated the trend to which you referred? Have the problems suggested by Brian Adam increased or changed?

Professor Beaumont: It depends on whom you talk to. Some people would say that the removal of the capacity for the in-house bid has worsened the situation. In some ways, it is unfortunate that the public debate has been shaped in those terms. Much of the media coverage has focused on whether PPP is privatisation by another name. That is not always a particularly constructive or positive debate.

The CIPD figures, which are the only act in town, show a downward trend in the quality of the relationship between unions and management in the public sector. There are all sorts of explanations for that and different people emphasise different explanations. The CIPD figures point clearly to deterioration in the past two or three years and they are the only decent set of data that exists.

The Convener: Alasdair Morgan has a question about the two-tier work force.

Alasdair Morgan: A lot of the issues have been covered. The witnesses mentioned the creation of a two-tier work force. Is that always one way or can the reverse happen: can wages and conditions sometimes improve so that there are better-paid private workers and more poorly paid public workers?

Dave Watson: We should separate two issues. There is not always a huge gap in pay, particularly in the initial years; there is a gap in conditions of service, particularly pensions. Professor Beaumont mentioned research. Page 4 of our submission refers to our research, which has been examined and commented on by the Treasury Select Committee and the Health Select Committee at Westminster. The research showed that

"90% of those contacted said pay levels for new employees were worse than for transferred staff."

That is a two-tier work force. Some white-collar sectors, where private staff have slightly better pay but maybe worse conditions, are an exception. In traditional blue-collar sectors—which cover the bulk of people who are affected by PFI—pay and, most important, conditions, such as sick pay, holidays and pensions, are worse. We are creating a group of people who will have no occupational pension scheme other than the new stakeholder pension arrangements.

A point that has not been covered on industrial relations is the rebirth of demarcation. For example, market testing or a PFI scheme might introduce into a health team in a hospital ward people who work for a different company. That breaks down the health team because it is decided that cleaners will only clean and nurses will do only certain things. In areas without PFI or market testing, we found a growth of housekeeping services and the creation of a health team to deliver services in particular wards. We want that industrial relations model to be developed in the health service and elsewhere. We do not want the recreation of 1960s-style demarcation.

Mr Davidson: You quoted a figure about conditions being worse for new employees. Will you give us—or send us—definite evidence that the figure discounts the fact that some people have better rates of pay and conditions, such as bonuses and holiday entitlement, because of their length of service? Can you separate out the benefits that employees tend to accumulate over time? Can you provide the committee with figures that are not a straightforward comparison?

Dave Watson: I do not think that the research shows that. The research that we produced for consideration by the Treasury Select Committee and the Health Select Committee at Westminster did not break down the figures into that detail. It showed a difference in wages but, as I said, wages are not the big issue. The big issues are conditions and pensions.

Mr Davidson: I want to hold you to what I said. I did not list simply wages; I mentioned holiday entitlement and sick pay. Please stick to the factual part of the question: can you provide the evidence? It is important that we discover whether there are clear differences and what they are. That is the evidence that we want.

Dave Watson: We can make the evidence to which I referred available to the committee without any problem.

Elaine Thomson: I have a small supplementary on pensions. I believe that employers who have more than about five or 10 employees must offer stakeholder pensions. Does that mean that new PPP schemes, for instance the ones with which Unison was involved in England, have been negotiated with no pensions?

Dave Watson: There are pension schemes, but they are not nearly as good as public sector schemes. In sectors with no history of pension provision, stakeholder pensions are an improvement, but they are a modest first stage in providing pension arrangements. The research to which I referred shows that none of the post-market testing or post-PFI pension schemes are as good as the schemes that were transferred from the public sector. I am not saying that none exist, only that we could not find any that are the same. Some form of pension provision will be made, but it will usually take the form of money purchase arrangements, for which most employers make only a modest contribution.

The Convener: We would like to receive any evidence that you have on that area, on a case-by-case basis.

Martin Gaughan (Transport and General Workers Union): I will take the committee back to the Scottish Executive's decision to take the roads contracts away from the local authority consortiums and to award them to Amey Highways Ltd and BEAR Scotland Ltd. That decision had dire consequences for our members, particularly in respect of pensions. Although the Cabinet issued guidelines, private companies do not strictly adhere to them.

For example, one of our lads, who was employed by Glasgow City Council, took ill in January 2001. He was advised two weeks prior to the transfer that he was going to be transferred across to the contractor. During the first week of the transfer, he went to get his wages from the bank, but there was no money there for him. Obviously, the local authority was no longer paying his sick pay. We contacted the council, which advised us that he had been transferred. Then we contacted the contractor, which told us that it did not employ him and that there was no onus on it to pay him. We managed to get the local authority to take him back, but I highlight that example to explain that the money-purchase scheme that was offered by the contractor is entirely different from the scheme that was provided by the local authority.

The lad in question is only in his 40s. If he had been retired through ill health, he would have had to wait until he was 65 to be entitled to any pension under the money-purchase scheme; under the local authority scheme, he would have been given early retirement on the ground of ill health. That is a major problem for people who are transferred under PFI/PPP schemes.

The Convener: We will move on to questions about TUPE.

Mr McCabe: There has been a substantial lack of clarity over how TUPE has worked. Can you explain how, in your view, TUPE is supposed to work? Has it been effective in protecting public sector employees? If TUPE were to be reformed, what reforms would you like to be made—in an ideal world?

Dave Watson: Members are probably aware that the UK Government's review of TUPE has been grinding on for about two years. A revised consultation paper has been produced on the basis of that review and we are hoping that a number of improvements will have been made.

Most of TUPE's legal difficulties have arisen around whether it applies to a particular transfer.

To be honest, my lecture notes on TUPE law change about every two weeks, because of various courts' decisions to vary this way and that the criteria for deciding whether TUPE applies. We are entirely as one with the Confederation of British Industry, the contractors' associations and others on the most important point, which is that we would all like some clarity.

The provisions should spell out that TUPE arrangements apply to first and secondary transfers, and to any other type of transfer, irrespective of whether there are assets or people, or any of the other daft legal tests that have been churned out. We would like it made absolutely clear that TUPE should apply to staff transfer situations. That would be a huge step forward and it would take away 90 per cent of the legal challenges over TUPE.

Consultation is the next big area. One of the problems with TUPE is that it makes no provision for consultation at the earliest possible opportunity—as happens with redundancy arrangements, for example. One could not enforce time scales, because—not in the public sector, but in the private sector—some deals are cut fairly quickly and late in the day. In those circumstances, it is difficult to enforce a time scale of 90 or 30 days for a consultation period, but including in the TUPE provisions a phrase similar to "at the earliest possible opportunity" would improve consultation arrangements. To be frank, the arrangements are very poor indeed at present.

11:30

In the public sector, it is possible to start at a very early stage. The staffing framework to which I referred earlier contains a string of provisions on the partnership approach to working, which would enable us to consider the issues at an early stage. That would be a distinct improvement.

There are other difficulties with the TUPE regulations and what happens post transfer. There are a number of myths about the TUPE regulations. Some people say that changes to terms and conditions can be made only within 12 months of the transfer. That is not the case; it was a misunderstanding of the early acquired rights directive. The reality is that changes to terms and conditions can be made at any time after the transfer, but they can be challenged if they are connected to the transfer. That is the legal position. Members will gather that that is a major legal minefield. Nobody knows when a change is connected to a transfer and when it is made for other good business or organisational reasons.

The last point on TUPE relates to pensions. At present, TUPE does not cover pensions at all. In the public sector, we benefit from Cabinet Office guidance—although it has not always been applied. I am sorry that I keep referring back to the trunk roads, but the guidance was not applied in that case and that has been gone over on many occasions. Guidance is not enough. Officials did not follow it in that case and no good reason was ever given for that.

We believe that TUPE should cover pensions specifically. We are not happy with the current consultation document on TUPE. It gives a number of options, but in our view none is satisfactory. We believe that the TUPE pension provision should say that when staff transfer they will be offered equivalent benefits and broadly equivalent administrative rules. There are two elements there.

Equivalent benefits would give the pension schemes the same status as other terms and conditions, such as pay and holidays. We accept that there is a need to change the administrative rules of pension schemes when trustees and the type of scheme are changed.

Other work could be done on pensions in Scotland. We suggested to the former Minister for Finance and Local Government arrangements for dealing with Scottish public sector pensions. We believe that there is merit in having a Scottish public sector pensions provision that would cover all changes in staff transfers and all changes to pension arrangements.

At present, every time a piece of legislation that reorganises the public sector in Scotland comes along, the civil servants have to go around reinventing the wheel, writing regulations and issuing changes in either primary legislation or secondary legislation to cover alterations to the pension scheme. We believe that there is merit in pulling that together in one piece of Scottish public service pension legislation. We believe that it is possible to do that under the Scotland Act 1998 and we would like arrangements to be made for it.

In the short term, a change to the TUPE regulations, which we hope the UK Government will adopt, will help in those areas.

Mr McCabe: I appreciate the answer that you gave, but I return to the point about how effective you think the TUPE regulations have been so far in protecting public sector employees. I appreciate the fact that that is a general question, but where, on a scale of one to 10 do you see the regulations?

Dave Watson: TUPE has been reasonably effective in protecting the terms and conditions of staff who transfer. It does nothing for the new starts or to prevent the two-tier work force.

Elaine Thomson: I want to move on and to ask what happens when PPP projects are introduced. There are a number of different phases—the design stage and the implementation stage, for example.

Previous witnesses have told the committee that one of the strengths of PFI and PPP projects is much improved project management: a lot more time has gone into the design of services, leading to lower maintenance costs later on.

How do unions get involved in current PPP projects, at both the design and the implementation stage?

Dave Watson: The answer is that unions hardly get involved at all at the moment. That has, however, improved somewhat in recent years in the health service in Scotland, with the adoption of the partnership arrangements. There has been involvement at a much earlier stage.

The staffing framework that we drew up in the health service—as I said earlier, it has ground to a halt—laid down stages of involvement. Trade union involvement was included in the earliest stages of the project, before any decision about the form of funding was taken. It is important to have an input into the early design stages.

The health service staffing framework deals with all the stages. It involves people in the initial stages, takes them through the various project stages of the PPP or PFI scheme and—if there is a staff transfer—deals with issues related to that as well. Outwith the health service, there was some resistance in the public sector, where there is less familiarity with partnership-type methods of working.

Various spurious reasons are given for not involving staff and trade unions at an early stage. Commercial confidentiality is the famous one. In fairness, previous witnesses to the committee have highlighted that commercial confidentiality is an entirely spurious issue in the early stages of a project. There is no commercial confidentiality until someone starts to put in hard prices and figures, or possibly some innovative solutions to particular problems.

If there is commercial confidentiality, there are confidentiality arrangements. All my trade union colleagues at this table attend negotiations that involve confidentiality every week of the year—it is a fact of life. Most of us spend most of our time in the private sector, where many such matters are share sensitive. We are used to dealing with that type of information. There is no reason not to involve early consultation.

In some parts of the public sector in Scotland, we suspect that the reason for not consulting at an early stage is that that would throw some light on the process, which some officials would rather we did not throw. Local authorities would be particularly reluctant to publish some of their documentation because they know that we would provide a thorough and detailed analysis of some of the information that they would present. That is why they have refused point blank to publish all sorts of information—even excluding commercially confidential material.

The essence is a proper staffing framework that involves trade unions at the earliest stage. There is some evidence of that in the health service, but there is not much evidence of it anywhere else.

Elaine Thomson: Can you refer to any specific examples of early involvement?

Dave Watson: Yes. In the health service, there was some early involvement in discussion about the Larkfield Road unit at Iverclyde royal hospital, where staff did not transfer. There was early involvement with some of the schemes in Glasgow. For example, trade unions were involved early on—ironically—in identifying several issues at the secure care unit there. In his report on the Glasgow secure care unit project, Dr Simpson pointed out some of the advantages of questions that the trade union had raised on the staff side. Those questions were not always listened to, but we did at least make an input at an early stage.

Elaine Thomson: I want to move away from trade unions specifically to the involvement of people generally with PFI/PPP projects. You talked about the Glasgow secure unit. How are employees in general involved in the different stages of PPP projects, whether at the design phase or at the implementation phase?

Dave Watson: Their involvement is fairly limited. There is usually some discussion. With a new hospital unit, for example, there would be involvement in some of the design issues. Sometimes that involvement is a little too late and sometimes not enough expertise or advice is given. Staff can be involved at an early stage in the design of a particular facility—that has been true, historically, for conventional builds as well as for PPP projects. There is a need to provide support and assistance on what is possible in the area of design, but we would argue that staff—with professional support—are the best people to make an input into the early design of any facility.

The Convener: I want to amplify that slightly. Are you saying that alongside the hard specification for the business operation of a facility there should be a soft specification for how the people processes might be handled? Is that the kind of thing that you are suggesting?

Dave Watson: I think that the two things should be intertwined. There is a risk in separating the two elements into soft and hard. The success of any operation, particularly in the public services, depends on getting the people issues right. One of our problems is that such projects have been viewed as an accountancy exercise, for which the number crunchers do the numbers and the architects and engineers do the technical design stuff, while the people side is left as an add-on. The process needs to be integrated.

Alex McLuckie: There are staff and there are staff. At North Lanarkshire Council, there is involvement with staff such as head teachers from an early stage, but the head teachers are not the people affected by any transfer. I am concerned that the people who are normally affected by a transfer are janitorial, catering, cleaning and maintenance staff. In my experience, the problem is that the first time those people are consulted is when they are introduced to their new employer.

It is wrong that the consultation with the trade unions is limited and delayed until the last possible minute. Normally, we are faced by a series of decisions that have already been taken and which we cannot influence, and when the case for in-house provision has already been lost.

Given the fact that many public sector employees have been delivering service over many years, there should be earlier consultation with the trade unions. Treasury guidance note No 4 details areas on which the unions should be consulted. In fact, what it suggests does not happen. The people most affected by PPP and PFI are those who are consulted the least. That is a major issue.

Elaine Thomson: I do not think that anyone disagrees that part of good, effective project management is about ensuring that all the end users—or everybody involved—are consulted at the very beginning. The end users have an essential role in the design process. Does Alex McLuckie see any change in that in the context of current projects? Do you have any examples of good practice in Scotland?

Alex McLuckie: I tend to deal more with local government. As far as local government is concerned, I would say that the answer is no. I still believe that the staff who are directly affected by PFI are consulted too late.

Professor Beaumont: In my evidence, I have referred to a particular master of business administration thesis. I gave the person who wrote it an assurance that I would not name them, but members can be assured that it is a fairly high-profile, recent MBA awarded in Scotland. A number of interesting phenomena were observed.

Because the initial decision making was so dominated by general management finance—which was quite right, because that is the perspective and strength of general management—other issues simply did not get taken on board and a very narrow perspective was taken. It was simply a question of whether it was possible to get the finance in place by a certain critical date. That had three interesting effects.

First, the managers concerned assumed that people like new facilities—as sure as night follows day—and they worked on that operating assumption. Secondly, the rumour mill started working big time, and they had nothing in place to offset its effects. Thirdly, because no one was speaking up for people management or human resources issues, there was a realisation along the lines of, "Oops, we forgot about that" after the event.

The managers had been concentrating on the finance. With all due respect to those involved, it was not rocket science. It was a matter of simple, basic communication with folks and of telling them what was going on. If decision makers miss the basic detail, that would seem to be a recipe for the sort of problems that those concerned are experiencing as we speak—literally.

Elaine Thomson: Do you accept that whether there is good communication among everybody involved is not a lot to do with its being a PFI or a PPP project? Good communication has more to do with good project management. You are talking about it in the case of a PPP project, but do you accept that, in the past, project management in the public sector—whatever it is like now—was awful to the point of being non-existent?

11:45

Professor Beaumont: One of the problems that the public procurement process had traditionally was a lack of in-house expertise. Public procurement folks have not had the status, terms and conditions, authority or power that the process deserved. I would go a not inconsiderable way towards agreeing with Elaine Thomson that insufficient value was placed on the public procurement folks. At the moment, the problem is that while there are a lot of good project management skills, a very strong steer needs to be given from people such as members of the Scottish Parliament.

Although I recognise the limitations of arguing by analogy, Robert Solow—the distinguished, Nobel laureate economist—once remarked that it is possible to see computers everywhere except in the productivity statistics. The analogy is good: when the design and implementation stages are separated to the point at which there is no overlap in personnel functions, mistakes will be made at the design stage that require a lot of implementation time to correct. That is why the productivity gains to computers and to new technology have taken so long to come through.

There are weaknesses in arguing by analogy, but because of the artificial segmentation of the process it is possible to see an analogous situation in some of the value-for-money projects.

Mr Davidson: I will pick up on the point about the MBA student. Is that thesis a rerun of the Harvard Volvo project of 25 years ago? That was about changes in working practice and the redesign of the production flow away from demarcation—the unions mentioned that—towards teamwork. If I remember correctly, the biggest issue that arose was that Volvo had to step up its human resources function to manage and communicate the change.

I return to that case study because some of the evidence that we have taken this morning indicates that, as Elaine Thomson mentioned, what is important is not the end user or consumer of the product but how companies take their work forces on board. That is what gives companies the perceived management and financial gains. Is that a reasonable approach?

Professor Beaumont: That is a reasonable description. In the case that we are talking about, there was a short-term focus on a single variable—to get the finance in place by a certain date—but sight of everything else was lost. As I said, I cannot go into too much detail, because members will work out quickly which company I am talking about. It is ironic that, because of the pressures of time deadlines, HR considerations were ignored and no one spoke up. This is not about revisiting socio-technical systems; indeed, the lessons could be extended to other stakeholders. Other folk missed out in the process and the costs and consequences that the company now faces are the result of people issues not being involved in the critical early part of the decision-making process.

Mr Davidson: You mention in your written submission that the Chartered Institute of Personnel and Development has produced evidence in this field. After the meeting, can you point the clerks in the direction of that work? Part of the remit of our inquiry is to examine such work. If you could assist the clerks with that, we would be grateful.

Professor Beaumont: Certainly. You are welcome.

Mr Davidson: Does anyone have specific evidence of either good or bad practice by PFI contractors? Does anyone have evidence of contractors upping the game and being easier to deal with? If not, is there definite evidence that the industrial relations performance of private contractors is poor?

Dave Watson: It is too early to tell with PFI in Scotland, as PFI schemes, including the big ones, have not been operational for long enough. The Hairmyres district hospital scheme has just kicked off. Some of the big PFI water schemes agreed early on that the staff would be seconded. West of Scotland Water, for example, is a PFI without people.

We do not have evidence either way about the industrial relations performance of PFI schemes. Since 1997, when the Government changed the staff transfer guidance rules, negotiations with contractors in some big PFI schemes have been a good deal more constructive. There have been agreements on transfer issues that might not have been achieved before the Government guidelines changed.

Procedures and agreements have dealt with some areas of concern, but they have not dealt with the issue of the two-tier work force. We will have to see in practice, as the PFI schemes come online, what industrial relations machinery and practice develops.

Mr Davidson: I take it that your union colleagues share that view and that they have nothing to add.

Throughout this session there have been—I will not use the word “claims”, as that is perhaps too strong—suggestions that there is less public scrutiny and transparency in PPP schemes than in public procurement schemes. Do you have evidence to suggest that that is the case? How would you improve the situation?

Dave Watson: The first Minister for Finance, Jack McConnell, made an announcement about openness arrangements in, I think, June 1999. He said, for example, that business cases should be published. The difficulty was that all the big schemes had been signed off before that announcement was made. There has been some openness since then and a few schemes are beginning to publish business cases. However, the big schemes were already signed off and so we have not yet seen any great advantage from the openness arrangements.

I agree with Elaine Thomson’s point about project management. However, I draw members’ attention to an important difference in openness between PFI schemes and public procurement schemes. In PFI schemes, spurious commercial confidentiality and other commercial factors come into play at an early stage. However, public procurement schemes start with design issues. They say, “Right. What do we want? We want a new school. What do want to put in the school?” All the end users are consulted and a specification is built up.

A PPP/PFI scheme produces only a broad specification at the early stages. Contractors then come along and say, “Well, actually, we would like to do it this way or that way.” The problem is that the contractors claim that people cannot be properly consulted, as the contractors have innovative solutions for a problem. The evidence about the Glasgow schools project illustrates that point.

Sometimes for spurious reasons, but occasionally for reasons that have some merit, a PPP/PFI scheme is less open and there is less consultation with end users at the earlier stages than is the case in a public procurement scheme.

Mr Davidson: Is that partly because the clients do not have the game sufficiently up to speed to be able to design what they seek to deliver over the length of the project?

Dave Watson: No. Lack of openness and consultation is a fundamental part of the structure of a PPP/PFI scheme. When we compare the stages of a PFI scheme with the stages of a public procurement project, we see that the PFI structure, as well as having commercial factors that come into play at different stages, causes lack of openness and of consultation. PFI schemes in Scotland could be considerably more open than they are. However, the PFI process will always be less transparent than the conventional build.

Professor Beaumont: I return to the point that Mr Davidson made about the contractors. To step outside the PFI process for a moment, I will add that some folks paint contractors as the sort of guys who always wear the black hats. My view, for what it is worth, is that contractors are an extremely heterogeneous collection of folks.

The chemical industry, for example, has a lot of expertise; it might be worth getting input from it. In recent years, the industry has upped hugely its use of contractors. Many people suggested that an adverse consequence would be a dramatic rise in industrial accident rates. In recent years, however, the Health and Safety Executive has complimented the chemical industry on its handling of our colleagues in the construction industry.

My understanding—I put it no more strongly than that—is that extensive use is made of interviews with contractors, particularly on health and safety performance. One suspects that good health and safety performance correlates positively with larger aspects of good industrial relations. There is a lot of accumulated experience, wisdom and insight in the chemical industry, although I accept the point that it is a different industry.

Mr Davidson: I visited Glaxo last week and got the impression that the industry was strong on that point.

Professor Beaumont: Absolutely. The industry has many useful insights that could be drawn on. It has arguably had more experience than almost any other industry in dealing with the issue.

Brian Adam: I have a supplementary question on the general area on which we have heard evidence. PFI/PPP is designed to build, finance and operate projects. The thrust of the unions' argument today is that, even under current arrangements, the operation part is not necessarily integral to such projects. The advice that other people have given us is that a major advantage of PFI/PPP is that such projects take into account whole-life costs and that the design and build of such projects relies on the operation side to ensure that, over the life cycle, there is a commitment to good maintenance. In other words, the long-term commitment is an integral part of the project. How would you rebut that, given that you clearly do not see the operation element as essential from the point of view of the private part of the project?

Dave Watson: PFI schemes, which typically cover 25 or 30 years, do not take account of the whole-life costs. It is not possible to work out the life-cycle costs of any building over that period, because regulations, maintenance techniques and staffing arrangements change. That is why in most of the big PFI schemes the operating element—particularly facilities management—is broken down and separated from the capital costs and the integral maintenance of the building. Often, the special purpose vehicles that companies set up to run schemes let out some of the facilities management elements of the contracts on shorter contracts. It simply is not possible to work out the life-cycle costs over the period of the contract.

However, whether with conventional procurement or with PFI, it is important to ensure that we design and build public buildings so that long-term revenue consequences are minimised. PFI and non-PFI hospitals have not always been designed with the long term in mind. We have always taken a short-term view of public buildings, although I suppose that that is not fair to the Victorians. In the post-war part of the 20^{th} century, we have built to reduce the capital costs of buildings and have not built with the revenue consequences in mind.

Whichever method of funding is used, we must take into greater account the revenue costs of running buildings, but that does not require control over the operating element of the building. One does not need to operate a building to take the operating element into account at the design stage; that is an issue for the design of the building. We argue that there is no need to include the operating element in design, build or finance. We have had no great difficulty with design and build; it is the finance element that brings in extra costs. The operating element brings other complications into the arena, which we have highlighted.

Brian Adam: As you have highlighted, the public sector has had a poor record over the past three decades, if not longer, of maintaining its buildings. Would PFI/PPP introduce that kind of discipline? If we do not want PFI/PPP to introduce that kind of discipline, how could it be introduced?

Dave Watson: We simply apply the same discipline at the design stage. The answer is that we do not know how well most of the buildings will be maintained under PFI, because it is early days. We have already given the committee a long list—running into several pages—of problems with maintenance and design in PFI schemes. I could have given the committee a book load of such problems. The jury is out on whether a PFI building is better maintained. However, let us say that it is. My answer would be that we should introduce to a public procurement method the same discipline on design and build as there is in the private sector. In other words, we should take into account the revenue consequences of the capital decision. That is not rocket science.

Brian Adam: Surely under PFI/PPP the risks are transferred to the private sector, whereas under other arrangements the risks are with the public sector.

12:00

Dave Watson: I am afraid that that is not true in all cases. Risk is often not transferred to the private sector. We could still build that in. We can insure; we can build all sorts of safeguards into a conventional build.

Mr McCabe: I do not know whether the matter is as simple as being about revenue consequences. Much of the maintenance of the building is to do with contract specification. You are right: it remains to be seen whether greater contract specification under PFI/PPP will produce more satisfactory results. Do you think that greater contract specification on maintenance in the public sector would be acceptable as an alternative to PFI/PPP?

Dave Watson: Are you talking about specification at the design stage?

Mr McCabe: I was talking about specification at the maintenance stage.

Dave Watson: That is one of the difficulties, whether we are talking about PPP or contracting out. Those of us who have worked in local government and the health service can think of all the efforts that have been made to specify the minute detail of the maintenance in the contracts. That is extremely difficult to do.

Many years ago, when compulsory competitive tendering was introduced, a long-standing public officer who was used to dealing with such matters specified in a contract on a public lavatory that the contractor should visit the toilets twice a day. The contractor visited the toilets twice a day, but the officer had not specified that the contractor had to clean the toilets twice a day. I tell that anecdote every time I am asked about the topic, as it illustrates the point that specifications have to be made in enormous detail.

Every contractor will say, privately, that they always price up to the specification on the assumption that they will make no profit at all. They make their profit from variations, because however good they are—and we have improved a lot since the days of that anecdote—they will always have problems in specifying.

I deal with big multinational companies that outsource various things. They will say that they have the same problems in specifying those issues. The process is very difficult. We can get better at it; we can share expertise, as was said earlier. Indeed, direct labour organisations did that through the Association of Direct Labour Organisations and other arrangements—expertise was beginning to be shared. With PFI/PPP, however, a lot of that good work has disappeared or has been dissipated.

Alex McLuckie: Competition is nothing new in catering and cleaning; we have had it for a long time under CCT. Given a fair wind, the direct labour organisation or direct service organisation can provide the service as well as the private sector can. We sometimes lose sight of the difficulty. The DSO is not given the opportunity to compete because of the information that is given out at an early stage where there has to be a transfer of risk. That is an important issue for DSOs. Competition is nothing new to cleaning and catering DSOs.

The problem with PFI/PPP is the concept that there must be a transfer to the private sector. There is competition between one or two private sector companies to provide a service. In a consortium, no one company deals with every aspect. A catering company deals with the catering, a cleaning company deals with the cleaning and a maintenance company deals with the maintenance. They all come together and no one company does everything.

If we are serious about best value, we have to consider all the providers, including in-house provision. That is not happening, however, because ill-informed people—or perhaps well-informed people who are determined on taking a certain route—are saying that there has to be a transfer. I believe that, when bids are considered against a contract specification, the DSO could compete for and win those contracts. Our difficulty is that we are not being allowed to because of the way in which people are interpreting the rules.

The Convener: We have exhausted our questions. I thank the trade unions and Professor Beaumont for giving evidence. On a couple of issues, we might want further concrete examples from you. You said that some local authorities have blocked the issuing of details of PPP/PFI contracts. If you have specific examples of that, we would be interested to see them. One of your summary points says:

"Many schemes are not affordable and result in substantial cuts in services."

If you have specific examples of that, again, we would like to see them. We will probably consider a number of other issues from your evidence; if you could supply us with further evidence on or examples of those, that would help the committee.

Elaine Thomson: We have been interested in examples of traditional or conventional public procurement that meet modern standards and provide the best project management. We would be interested in some examples of that.

The Convener: I thank our witnesses again for their evidence, which we will ponder. I suggest that we take a short break for three or four minutes. Our next items will be in private.

Alasdair Morgan: I have one point to mention before we go into private. It is important to mention it in public. It had not quite clicked with me, convener, that you declared your membership of the Scottish Parliamentary Corporate Body. The committee has an unusual role in that we scrutinise the accounts of the SPCB. How do you intend to address that issue the next time that it crops up?

The Convener: I have asked the clerk for advice on any potential conflicts of interest that relate to that. While I remain a member of the SPCB, my intention is to step aside from any discussions on that matter and hand over the chair to the deputy convener. I hope that you will bear with me until I get advice from the clerk on the issue.

12:07

Meeting adjourned until 12:15 and thereafter continued in private until 12:52.

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