

FINANCE COMMITTEE

Tuesday 23 April 2002
(*Morning*)

Session 1

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FINANCE COMMITTEE

8th Meeting 2002, Session 1

CONVENER

*Des McNulty (Clydebank and Milngavie) (Lab)

COMMITTEE MEMBERS

*Brian Adam (North-East Scotland) (SNP)

*Mr David Davidson (North-East Scotland) (Con)

*Mr Tom McCabe (Hamilton South) (Lab)

*Alasdair Morgan (Galloway and Upper Nithsdale) (SNP)

*Mr Jamie Stone (Caithness, Sutherland and Easter Ross) (LD)

*attended

THE FOLLOWING ALSO ATTENDED:

Professor Arthur Midwinter (Adviser)

WITNESSES

Dr Ingrid Clayden (Scottish Executive Corporate Services Department)

Andrew Clearie (Scottish Executive Finance and Central Services Department)

Paul Gray (Scottish Executive Corporate Services Department)

Mr Andy Kerr (Minister for Finance and Public Services)

Graham Owen (Scottish Executive Finance and Central Services Department)

Paul Rhodes (Scottish Executive Corporate Services Department)

Sandy Rosie (Scottish Executive Finance and Central Services Department)

Ian Walford (Scottish Executive Corporate Services Department)

Joanna Young (Scottish Executive Finance and Central Services Department)

ACTING CLERK TO THE COMMITTEE

David McGill

SENIOR ASSISTANT CLERK

Terry Shevlin

ASSISTANT CLERK

Gerald McNally

LOCATION

Committee Room 2

Scottish Parliament

Finance Committee

Tuesday 23 April 2002

(Morning)

[THE CONVENER *opened the meeting at 10:06*]

The Convener (Des McNulty): Welcome to the eighth meeting in 2002 of the Finance Committee. I have received apologies for lateness from Jamie Stone and Brian Adam, but I am told that they are both on their way. The committee adviser, Arthur Midwinter, is attending today's meeting.

I draw members' attention to the additional questions for the minister on public-private partnerships and the private finance initiative. Those papers were sent out late last night.

Mr David Davidson (North-East Scotland) (Con): Who are the authors of the additional papers?

The Convener: David McGill and I produced the additional questions.

Mr Davidson: Thank you.

Budget Process 2003-04

The Convener: I welcome our witnesses from the Scottish Executive: Ian Walford, director of corporate development; Dr Ingrid Clayden, director of personnel and pay; Paul Gray, director of information technology; Graham Owenson, head of division finance administration and pay policy; Paul Rhodes, head of accommodation division; and Joanna Young, head of expenditure policy.

Perhaps one of you can give us an overview of your part in the budget process.

Graham Owenson (Scottish Executive Finance and Central Services Department): The witnesses round the table are responsible for the lion's share of the budget. Following our last meeting in October, when we considered the draft budget document, we have made several changes to the layout of the chapter on the administrative budget. We have looked at the disaggregation of the budget and tried to make it more informative. In general, it follows the layout of the information that we use in the accounts. There is now a clear link between the budget and the accounts that was not there before.

The other piece of work that we have done since we last spoke to the committee is a fairly major overhaul of the objectives and targets. Without wishing to say "Never mind the quality, feel the width", I would point out that that information now runs to some four pages. That follows up some of the discussion that we had at our last meeting.

Joanna Young (Scottish Executive Finance and Central Services Department): Do you want us to describe what we do and how it relates to the budget?

The Convener: I was looking for an overview of your role and scope of activity in the budget process. It would be interesting to get a view on the management issues attached to expenditure policy.

Joanna Young: A part of the chapter relates to the administration budget, which is the cost of supporting the Executive. It reflects the costs of civil servants, accommodation and information technology. By its nature a number of different people's budgets are reflected within the overall administration budget. Graham Owenson and I have the overview of the budget and we report to the management group, which is the overall overseer of the budget. The management group is chaired by the permanent secretary, so it has a management dimension, which takes it slightly away from the direct ministerial involvement that there is for the other chapters. There is not much more to say. We are here to respond to any questions that the committee has about the size of

the budget, what it does and what it delivers.

The Convener: Do any members have specific questions?

Mr Davidson: What sort of time scale difficulties do you have? Can you explain why it seems to take such a long time to get level 3 figures out? We just want to get access to them. What difficulties do you face, as the people who are grinding away to produce the goods?

Graham Owenson: Are you asking about the difficulty in getting level 3 figures out for this budget document?

Mr Davidson: At any time, within the work that you do.

Graham Owenson: It takes time to get final figures for outturn in the past year. We are still putting that together. It will be some time before we can report exact figures, although we have an idea of the outturn statements. There are constraints on that through the accounting system. It is a matter of getting the IT right to ensure that we can carve the cake up in a reasonable way and give a more informative view of our budget. There are no real constraints. The IT is now in place, so we can get this sort of information out of our budgeting systems fairly easily.

Mr Davidson: As the IT is now in place, what difficulties would you have in producing in-year reports, perhaps every six months, on how the roll-out of different programmes is running?

Graham Owenson: We would not have difficulties in doing that. We can and do monitor at that level.

Joanna Young: Separate discussions are going on about how much information will come back to the committee at regular intervals. We should not necessarily invent a different system for this part of the budget.

The Convener: I will ask about the project management of the introduction of the IT system. I know that you are now in a new phase of examining IT systems. How is that going? Is the system now completely on course for successful operation?

Graham Owenson: Are you talking about the accounting system?

The Convener: The Oracle Financials system.

Graham Owenson: Yes. The Scottish Executive accounting system—SEAS—has had some early teething problems. Those are settling down as we get into the new financial year. Processes are in place to ensure that all payments are going out the door and everything is being accounted for centrally. There were some early teething problems, but all payments are now being

made on time.

The Convener: Are you saying that the problems have all been rectified and resolved?

Graham Owenson: The resources are now there to rectify them. The past problems that we had with the system have been identified and are being addressed.

The Convener: I have a question about project management of those kinds of IT issues. What lessons have you learned about budget management and operational management from that process?

10:15

Paul Gray (Scottish Executive Corporate Services Department): One thing that we do on all major projects is to carry out a project evaluation review to feed in the lessons that have been learned. One lesson that we have learned from recent major projects is that a more detailed assessment of risk and the contingencies that are needed to address the risks is a crucial component of any project. Work is going on throughout the Executive on risk assessment and putting appropriate contingencies in place, not only for IT projects but generally.

Another problem that we constantly come up against is that there is a tendency to underestimate the amount of resource that is required to engineer a business change. IT projects are not only about putting in a system, but about getting people to do things differently and more efficiently. Another lesson that we have learned is that helping people to understand the purpose of an IT system is a crucial component of successful delivery.

Those are a couple of key points that we have drawn out and will include in assessments that we make of bids for IT funding that come along in the future.

The Convener: Will you produce a review or analysis of the project management system for IT change within the Scottish Executive? Is that a matter that the Finance Committee might be able to have a look at in due course?

Paul Gray: We update our guidance to project managers regularly. That is endorsed by the Scottish Executive information systems steering group, which meets regularly. I see no difficulty in giving the Finance Committee sight of the latest version of the guidance, if it would find that helpful.

The Convener: It would be interesting to see the guidance.

Alasdair Morgan (Galloway and Upper Nithsdale) (SNP): I have a question about the figures that are in the draft budget for 2003-04 and

beyond. Clearly, the figures are significantly out of date, in the light of the budget at Westminster last week. What mechanisms do you go through to produce the revision to the draft budget that will be necessary to reflect the decisions consequent on the chancellor's decisions?

Graham Owenson: Budget consequentials will be considered in the course of the spending review 2002. The draft budget document is the start of that process. Serious considerations will take place internally in discussions involving ministers, departments and officials. That process will carry on over the summer and final decisions will be made sometime in the autumn, probably in September. The administration budget will be considered in the same way as any other departmental programme budget is considered, and the implications for health and education will be taken into account.

Alasdair Morgan: What is the differential in the work load that is involved in producing the budgets in a year when there are significant budgetary changes?

Graham Owenson: It is large.

Alasdair Morgan: Are you saying that you will have problems in meeting what you think would be a reasonable time scale?

Joanna Young: That issue cuts across the whole of the Executive. The spending review process that ministers have set out is a challenging and demanding one, but it is a mechanism for ensuring that future resources are aligned to priorities. The process is resource intensive for officials and ministers throughout the organisation and a lot of work will be going into it during the next few months. That is part of the business of government and of making those sorts of decisions. It is necessary to get information together, to submit proposals, to justify proposals and then to have a process of negotiation and debate before the final decisions are made. The figures for 2003-04 across the piece will inevitably be subject to some change when the spending review announcements are made, which will be by 20 September to fit in with the rest of the budgetary cycle.

Mr Davidson: Could you update us on e-procurement? I gather that a serious amount of money has gone out from the budget and you are looking to purchase an e-procurement system. How is that going? Is it on track and is it delivering the savings that you anticipated when the programme started, or will it do so if it is not running yet?

Paul Gray: The e-procurement project is on track. We have been successful in encouraging a number of organisations outside the Scottish Executive to join in the programme. The savings

will take some time to deliver, because they will accrue from improved efficiency in procurement in organisations, and, later, from the opportunity to aggregate procurements across parts of the public sector. Internal efficiencies should accrue before the benefits of aggregated procurement are felt.

A programme of work to encourage more local authorities and health trusts to participate is well under way. An implementation programme is also in place, which shows progress over the next two years in getting those bodies on board. The first stage of bringing any organisation on board is to conduct an assessment of its current situation, which we call a scope and readiness assessment. The early adopters, of which the Scottish Executive is one, are at that stage. That involves considering the shape and size of the organisation's IT systems and business processes to ensure that they link effectively with the e-procurement system.

Mr Davidson: Who is ultimately accountable for the system's development? What incentives are being offered to likely participants?

Paul Gray: On accountability, the e-procurement programme has a project board. I am a member of that board, which is chaired by the principal finance officer. Other members include people from outside the Scottish Executive and representatives of the supplier of the e-procurement system. The main incentives to joining are the internal efficiency and overall procurement savings that we regard as achievable by adopting the system. The assessment of the savings is based on experience elsewhere. We have not drawn it up in the abstract.

Mr Davidson: I will provide some background to my question. I have the impression that the incentive for area tourist boards to join in with the e-commerce system that is being promoted in the latest public-private partnership, with Etourism Ltd, is that if the ATBs do not join, their funding will be reduced. Is such a threat likely to be made towards local authorities and health boards? Is any compulsion likely, given your investigations so far?

Paul Gray: I can answer those questions in part. I will hand over to my finance colleagues for the other parts. I understand that a sum of money will be top-sliced to encourage health trusts to participate in the initiative. I do not have information about top-slicing money from local authorities.

Graham Owenson: No decision has been taken on top-slicing local authority budgets to encourage local authorities to participate in the initiative. Several have expressed interest. As far as I know, discussions continue with the others.

Mr Davidson: That is helpful.

The Convener: How does staff pay reform feed into the budget? Will you say something about the new pension arrangements?

Dr Ingrid Clayden (Scottish Executive Corporate Services Department): I cannot yet talk about the new civil service pension arrangements that will be introduced.

The Convener: Do the new pension arrangements carry any financial implications?

Graham Owenson: I am unaware of any implications.

The Convener: I presume that you can talk about pay reform.

Dr Clayden: I am not sure what you want to know about the costs of pay reform.

The Convener: What new structures are being adopted? The budget contains a breakdown table of the numbers of people who are involved in various sections of the civil service. The three-year pay deal to cover the period from August 2000 to July 2003 is in place and may have had implications for staff costs. Will you expand on those issues?

Dr Clayden: We introduced a new pay system in August 2000. It was designed primarily to improve the performance of the Scottish Executive and, in doing so, to reward staff for their contribution. Key problems that we addressed included a minimum wage for our most junior staff in band A1 and bringing their salaries up to a reasonable level largely for Edinburgh, as most of our staff work in Edinburgh. We also dealt with recruitment and retention difficulties that we faced with other staff in the Edinburgh market.

A third element of our pay deal was to improve progression through the pay ranges. That related to possible equal pay issues that can be raised by long and slow pay progression and to an attempt to keep pace with the recruitment pressures that we face in the current market.

The Convener: I was not a member of the committee when Dr Clayden told us last year that churn—staff moves and turnover—was high in the Executive, at about 30 per cent. Does the figure remain as high as that? Are you beginning to overcome the problems that are associated with that figure?

Dr Clayden: Churn in the Executive remains high. In part, that is because we continue to recruit staff, which leads inevitably to some change. The rate has slowed since I gave evidence to the committee last year, but we continue to feel that we must take some action and we are about to embark on a programme of work to try to stabilise the organisation more.

Some churn is intentional. We want interchange,

as we want people from outside to give us their knowledge and, in the same way, we want our own people to go out and experience working in other sectors, because that helps to share knowledge and understanding. We will always have that.

The churn that we want to deal with is caused by internal movements between jobs and progression within bands, which is happening too quickly to allow people to consolidate their knowledge and understanding of their work. We are preparing guidance on career management for staff, so individuals and their line managers will understand better how we view progress through the Executive. We are doing that to try to slow the rate at which people move and to get folk to work for a period in one area and consolidate their knowledge of that area before they move on. We are taking steps to dampen down such internal movement.

Alasdair Morgan: The target for sickness absence next year is six and a half days. How does that target compare with the rate in similar administrative organisations?

Dr Clayden: In comparison with 24 other Government departments, we are the sixth lowest for sick leave.

Alasdair Morgan: How about the private sector? I know that nothing exactly comparable exists in the private sector, but do you have a feel for the sickness absence rate in largely office-based organisations such as insurance companies, of which Edinburgh is full?

Dr Clayden: I have no information on that.

Graham Owenson: Neither have I.

Alasdair Morgan: In setting the Executive's targets, do you consider what non-civil service organisations are achieving?

Dr Clayden: We have not done that so far. Perhaps we ought to obtain a comparator with the big insurance companies in Edinburgh, for example.

Alasdair Morgan: The Executive is very keen on obtaining comparators from the private sector and approaching it for everything else, so I am surprised that it is not doing that for sickness absence figures. The estimated average absence for last year was 7.7 days and your target is 6.5 days. What steps are being taken to reach that target and have you any hope of reaching it? If you do reach it, what will have helped you to do so?

10:30

Dr Clayden: Yes, we still hope to reach that target. Progress has been slower than we would

have liked, partly because the absence management procedures that we have been developing are not yet in place. We intend to put them in place from 1 June. We believe that they will improve the reporting of sickness absence. They will introduce, as a fundamental activity, return-to-work interviews of people who have been on sick leave. That will obviously raise the profile of sickness absence and sickness absence management. We hope that we will gain a better understanding of what lies behind the problem.

We are also doing other things that we hope will push us towards our target. Work-related stress and domestic issues may affect sickness absence. We have therefore undertaken a staff survey on stress. We want to find its causes and consider how we might tackle them. We hope to have results next month.

We have introduced an employee assistance programme, supporting our current counselling service. It offers staff the opportunity to talk to trained counsellors about work and non-work issues that cause them concern. We have also surveyed staff about their preferences for alternative working patterns. We wonder whether leave for domestic reasons is related to child care or other matters that might be resolved by alternative working patterns, which we hope to pilot in the autumn.

Alasdair Morgan: On the issues of absence and recruitment—where there seems to be a problem—is there any interaction when the Executive or the Parliament requires particular things to be done or particular information to be supplied? How do you try to get the message across that a particular requirement cannot sensibly be met with the number of staff that you have without staff leaving or sickness absence rising? What is happening because of the pressures that are being put on you? Do civil servants automatically say, “Yes, we’ll go away and do what you ask,” or is there resistance, with people saying, “No, we cannot sensibly do that”?

Dr Clayden: My colleague Ian Walford will add to this in a moment, but we are considering various possibilities for working in different ways—working smarter rather than just working harder and doing more. We will put ourselves in an untenable position if we carry on trying to do everything that is asked of us, as we have been doing until now.

Ian Walford (Scottish Executive Corporate Services Department): Since devolution—and even before that—we have been considering how to change and improve continuously. Obviously, devolution brought a large increase in the amount of work—with the Parliament and the increased number of ministers, parliamentary questions and items of correspondence. That happened

alongside the civil service reform programme at Whitehall.

As the budget document says, our aim is to become more effective and efficient. We have a range of initiatives and programmes. We are trying to exploit the IT systems in the Executive to allow us to produce briefings for ministers more quickly and to allow us to track ministerial correspondence more effectively. We have a new performance management system that we hope will tie up the objectives of staff within the programme for government to ensure that things are delivered on time.

A huge range of activity is going on throughout the Executive to help us to become more effective and efficient. There may be a ceiling—a point at which we will not be able to improve further. However, all Executive staff are surveyed each year—we have just had the third such survey—and the results have been quite encouraging. Around three quarters of staff felt satisfied with their job and felt that it was challenging. The feeling of being valued is also increasing.

The Convener: There is a constant debate about civil service reform. Does the Executive plan to draw together some of the lessons of the first years of devolution and to consider their implications for the civil service? Would it be useful to have such discussions in parliamentary committees? Such discussions would come within the Finance Committee’s remit and they might be of interest to other committees as well. What has been the impact of devolution on the administration of the Scottish Executive? It would be interesting to hear views from inside the organisation. I leave that thought with you.

On page 265 of the budget document, you say, on the subject of accommodation, that a facilities management review has a target of making savings of £2.1 million. That is a substantial sum of money. Are you confident that the target is realistic? What progress are you making towards it?

Paul Rhodes (Scottish Executive Corporate Services Department): We are confident that the target is realistic. We engaged consultants to help us to investigate the organisation of services and we involved the trade union side fully throughout the review process and in the agreement to introduce a business improvement programme. The trade union side and the consultants are also satisfied that the target is achievable.

We have set up a board to manage the project. We are using a project management approach called Prince2, which involves project initiation stages. We are going through those at present—for example, assessing risk and ensuring that all risk is highlighted at the start of the project.

Mr Davidson: I note that you will dispose of five buildings over a four or five-year period. How much of the £2.1 million will that account for?

Paul Rhodes: None.

Mr Davidson: So those savings are still to come.

Paul Rhodes: Those savings were all accounted for in the previous spending review. We planned to give up those buildings and incorporated those savings in our finances over that period.

Mr Davidson: I note on the same page that staffing has gone up by 20 per cent over four years. Could you explain that difference? Were you previously under-staffed because not enough people were around when you planned to take on staff? Is there a particular reason for the increased work load in pressure areas that could account for the rise in recruitment?

Dr Clayden: It is fair to say that there has been pressure right across the Executive. There have been hot spots during those four years, but there has been a general increase in activity—in legislative work, in parliamentary questions, in green folders, and in all the bread-and-butter work of the organisation. There has also been a general increase in new policy development. I would not like to point to one part of the Executive and say that it has been under more pressure than any other.

Mr Davidson: Let me refine the question. As you inherited many of the Scottish Office's functions, you will have known the recruitment requirements—the number of bodies needed—to deal with the bread-and-butter issues. Can you highlight the areas in which the number of staff has increased since the Parliament came into being?

Ian Walford: Since July 1999, 232 consultation papers have been published—that is a large increase on previous years. There is now 60 per cent more correspondence—ministerial correspondence and correspondence from the public—than there was pre-devolution. Six times as many parliamentary questions are now asked. There have been 22 Executive bills compared with one or two a year pre-devolution. That will give members an indication of the amount of extra work that devolution has generated for the Executive.

Joanna Young: I will add a general comment. With parliamentary devolution came a wholesale change in the way in which Government in Scotland worked, including closer working with external partners, such as the voluntary sector, local authorities and health boards, and direct involvement with what happens on the ground. Ian Walford mentioned the increase in the number of

consultations. There was more of a sea change in the way in which Government in Scotland worked than was anticipated.

The Convener: That bears out the point that I made earlier. It would be useful to have a numerical breakdown of the way in which the work has changed and qualitative information of the kind that you have just given. That would allow us to form a sense of how the Executive has altered the administrative way of working in the context of devolution, as opposed to the difference in policy issues, which is better dealt with elsewhere.

Alasdair Morgan: The target for energy usage has gone down from 211kWh a square metre to 209kWh a square metre. I have no idea whether that is good or bad, because I do not know how it compares with the figures for other organisations. Does either figure compare well with office energy usage elsewhere? It strikes me that a reduction from 211 to 209 is remarkably precise. I know that that is inevitable when numbers are involved, but how does the Executive hope to reduce energy usage by what is in effect 1 per cent?

Paul Rhodes: Our bills tell us how much energy we have used and we know how many square metres of building we have.

Alasdair Morgan: So do I.

Paul Rhodes: The actual figure has a lot of decimal points after it, which we have cut out. As part of our general environmental objectives, we have an energy improvement programme, the "Greening Government" policy statement and an environmental management system in Victoria Quay. Such procedures are intended to identify areas in which changes can be made that will assist in meeting targets. We work out what we think we can achieve and turn that into a target. The overall UK Government target for Government departments is a 1 per cent a year reduction in energy usage, but we chose a slightly tougher target for the first three years. We are considering how to proceed in the future.

A range of measures can be taken. In our building, there have been significant increases in insulation, radiators have been made more controllable and we have had a report from consultants on the settings of the system. We have made major strides in reducing energy usage—we have even made changes in some of the information technology kit, as some new kit has a lower demand for energy. We have brought together a range of measures to help to reduce energy consumption.

Alasdair Morgan: I want to return to the first part of my question. Edinburgh is full of office blocks. How do Government office blocks compare with the other ones?

Paul Rhodes: The benchmarking with which we are involved is solely with UK Government departments. Previously, the data were reported to the Environmental Audit Committee at Westminster and were pooled with other Government department data. Our data fared pretty well there.

Brian Adam (North-East Scotland) (SNP): I wonder whether it is possible to consider the revenue costs in isolation. If the target is a 1 per cent saving in revenue costs, but making that saving costs an enormous amount in capital expenditure, reaching the target still costs money. Nowadays, all sorts of white goods have an energy rating but, given the lifetime costs, one does not save much by choosing those that have lower running costs. Does the Executive analyse whether there will be lifetime savings from capital investment that provides significant reductions in revenue costs?

10:45

Paul Rhodes: Yes, particularly when the consultants suggest that we spend money on the way in which a building works, for example on a new boiler. Such improvements are assessed against the likely savings over their lifetime. Not all IT changes are related solely to electricity usage, but energy savings can be part of the benefits of using a different type of system. The energy savings from the IT changes that I mentioned were not a principal reason for the changes. The payback period is a factor when we are considering energy-related investments.

The Convener: That concludes the evidence session. I thank the witnesses for their evidence, which will fit into our consideration of the budget.

Contingent Liability (Amendment)

The Convener: I hope that we will deal quickly with agenda item 2. Members have a paper from the clerk on the matter and the amendment to the contingent liability is attached. As the paper explains, the amendment is to the number and type of clinical trials that are carried out by the Scottish National Blood Transfusion Service. It is expected that the liability that the committee approved last year will be unaffected by the revised programme. The amendment is copied to us in line with the committee's request when it approved the liability.

We should thank the Executive for bringing the matter to our attention. The paper from the clerk suggests that we simply note the amendment and take no further action. Do members have any comments?

Mr Davidson: Having been through the previous rounds on the matter, I think that the questions that the committee asked at that time have resulted in the liability coming back to the committee to give us an opportunity to comment. I have some knowledge of the matter. If we are assured that the liability has not altered, I suspect that that is because there has not been enough time for anybody to suffer problems and to have an indemnity claim. I suspect that we are back in the same situation as we were in when the paper was before us previously.

The Convener: We should note the position.

Members indicated agreement.

Local Government Covenant

The Convener: Agenda item 3 is the covenant between local authorities and the Scottish Parliament. The commission on local government and the Scottish Parliament recommended, through the McIntosh report, the establishment of a covenant and a joint standing conference between local government and the Scottish Parliament. A draft covenant has been produced. We are asked to consider it and to supply any comments that we have to the Local Government Committee. A short paper by Arthur Midwinter highlighting issues that are of relevance to the committee has been distributed to members.

Professor Arthur Midwinter (Adviser): My paper tries to relate the covenant to the role of the Finance Committee. In recent years, trying to provide a local government view has created growing tension in the Convention of Scottish Local Authorities. There is pressure in COSLA to come to a single view, but it is almost impossible to get a local government view on matters such as local government reorganisation and grant distribution. It is important that the Finance Committee and the Local Government Committee have access to a range of views rather than one that emerges simply through the political processes in COSLA.

The draft covenant refers to “regular meetings”. I am not sure whether that means two a year or whether further meetings are envisaged. I am not sure that more meetings would be particularly productive. At present, the Local Government Committee invites up to five councils to give evidence on the budget. Perhaps that ought to be formalised so that every council has at least the opportunity to give evidence. I am not sure about that; maybe the matter should be left to the Local Government Committee. The covenant proposes that meetings take place in April and October. It would be helpful to the Finance Committee if the April meeting took place after the annual expenditure review so that the local government side had a chance to consider the review before its meeting with the Local Government Committee.

By October, the Local Government Committee will have received its written and oral evidence from councils and it would be helpful if that meeting could take place before the end of stage 2 of the budget process. That would enable COSLA to have a discussion about its wider view of the issues that have been raised in evidence with the Local Government Committee.

The Convener: Arthur Midwinter made three helpful points.

Mr Davidson: I have always thought that it is ridiculous for Government to expect COSLA to

come up with a one-size-fits-all prescriptive model of what is ideal in local government. Every local council has to deal with its own set of problems, its own culture, its own environment and its own community. I am not convinced that there should be an expectation that COSLA should produce a view. COSLA should merely be a representative body that facilitates opportunities for its members—or others—to deal directly with Government, given that the settlement comes directly from Government to local authorities.

I agree totally with Professor Midwinter’s final comments on paragraph 22, which deals with the timing of the budget process—they make absolute sense. I am not convinced about what the covenant will deliver. A covenant usually delivers something, but I do not think that COSLA is in a position to do so or that Government should expect it to. It is vital that the Government defines individually with each council how it works. Government should also define how open and transparent its relationship with each council will be, but I am not sure what two conferences a year will deliver for anyone.

I would love to know what the cost of the covenant will be. Usually, when we get papers such as the paper on the draft covenant, there is some indication of what the cost to the budget will be.

Mr Jamie Stone (Caithness, Sutherland and Easter Ross) (LD): For the record, I take slight issue with David Davidson’s comments. Those of us who have worked with COSLA over the years know that it has never sought to put forward a single view. Rather, it has expressed a balanced menu of views that takes into account the needs of the central belt versus those of rural areas. I think that COSLA does that quite well.

The danger in David Davidson’s proposal is that he almost signs COSLA’s death warrant. Let us think things through. COSLA has a useful role in co-ordinating council responses and in presenting to us not a single view but a spectrum of views. I stress that COSLA has another function that is quite useful from the point of view of council back benchers, rather than from that of council leaders—it is a resource for those councillors. The covenant is a positive way forward and we should not rubbish it until we have tested it and tried to make it work. It has worked in the past—COSLA has been successful—and the covenant gives us an opportunity for the future.

Mr Davidson: May I respond to the comments that have been made, convener?

Alasdair Morgan: On a point of order, convener. Although the discussion may be fascinating, I think that we are heading outwith the committee’s remit.

The Convener: That is a fair point.

Mr Davidson: I was not attacking COSLA. I see COSLA as a body that facilitates opportunities for its membership—I thought that I had made that view perfectly clear. I do not think that it is possible for COSLA to come up with one view that fits in with all councils' views.

Brian Adam: Given the fact that COSLA no longer represents all local authorities in Scotland, the document contains some weaknesses that may well impact on local government finance, which is a matter that we think is relevant. Councils withdrew from COSLA partly because of the different views that they held about how local government is financed. I am concerned about the suggestion that is made midway through the bullet points in paragraph 16 of the draft covenant. The document says:

"COSLA will undertake to provide a co-ordinated response which takes account of the views of the individual councils."

I do not know how COSLA will represent the views of councils that are not members, particularly if those councils have views that are different from those of the majority of councils in COSLA. I suspect that that might be the case.

The idea of formalised arrangements between local government and the Parliament is very sensible and I hope that we can get to that point. However, I am worried about how they are being formalised. I hope that we are not going to tell councils that do not choose to be members of COSLA that their views will not count because the Parliament has an arrangement with those that are in COSLA.

Mr Tom McCabe (Hamilton South) (Lab): Brian Adam is reading a lot into the document, but none of the fears that he has expressed are in print. COSLA will represent those councils that are members—it is as easy as that.

The Convener: I have two points. I am not sure of the value of a quasi-legal document as opposed to a more informal statement of best practice, which might have been a better way to proceed. The draft covenant looks retrogressive in the way that it is drawn up as a traditional document rather than as something more user-friendly.

The second issue is that some of the terms in the document appear to suggest that COSLA should be the designated consultee in all circumstances. I can imagine circumstances where committees might want to consult specific local authorities on the particular policy areas in which they are involved. In such cases COSLA might not be the most appropriate consultee and the covenant could tie the hands of committees unduly.

With that point in mind, perhaps we should suggest to the Local Government Committee that the document needs to be a wee bit more flexible.

Professor Midwinter: I agree. The Local Government Committee was conscious of those problems last year. Falkirk Council was invited to give evidence, specifically because it is one of the councils outwith COSLA. All those councils have the right to make written submissions. I find it difficult to imagine a situation in which Glasgow City Council did not let anybody know what it felt. As long as people are aware and try to be fair across the board, I do not think that there will be any difficulties.

The Convener: I suggest that we take those comments on board and put them in a letter to the Local Government Committee.

Item in Private

The Convener: Agenda item 4 is to ask members whether they want to take their case study reports in the private finance initiative/public-private partnership inquiry in private at the next meeting. Is that agreed?

Members *indicated agreement.*

The Convener: The next item is the PFI/PPP inquiry. Andy Kerr is scheduled to be here at 11.15, so we are a bit ahead of ourselves. I suggest that we suspend the meeting for 15 minutes, but I ask members to stay for two or three minutes to discuss questions.

Alasdair Morgan: I do not know how long you expect item 6 to take; would it be possible to deal with that now?

The Convener: We need representatives from the Scottish Parliament information centre to speak to us and they are not here at the moment.

10:58

Meeting suspended.

11:13

On resuming—

Private Finance Initiative/Public-private Partnership Inquiry

The Convener: We move to agenda item 5 and welcome Andy Kerr, the Minister for Finance and Public Services, to give evidence in our PPP/PFI inquiry. I invite the minister to make a brief opening statement.

The Minister for Finance and Public Services (Mr Andy Kerr): I want to explain briefly my role in relation to PPP policy and funding in Scotland. I also want to answer your questions on the issue as best as I can. Sandy Rosie and Andrew Clearie are here to help me with that.

I have done my best to read the *Official Report* of some of the committee's previous meetings. You have fairly gone into detail and a wealth of evidence has been gathered. I hope that we can add the Executive's view on PPP.

I take the lead in the Executive with regard to PPP policy and guidance. Clearly, individual ministers take responsibility within their service areas and ministerial portfolios. I am responsible for public services and PPP plays a part in all of that and will continue to play a key part in our strategy for improving public services.

PPP remains in our armoury because it makes good sense. To use an apolitical tenet, it provides an effective response to important public needs and that is why it is there for the Executive to use. PPP answers the need for increases in resources and infrastructure in the public sector.

11:15

As the committee is aware, PPP covers many areas. In terms of the Executive, however, it is worth placing PPP in context. Although it plays an important role, it makes fairly modest demands on the Executive budget. To give some scale, we have increased conventional capital spending by more than 25 per cent between 2001 and 2004. In relation to that, PPP is only 10 per cent of the total capital spend. Although debates go on about PPP being the only show in town, at 10 per cent, it does not quite meet that accusation.

The important thing is that PPP meets some of the additional expectations that our communities have about public services. The total whole-life cost and the effect that it has on the revenue budget in Scotland is less than 2 per cent of the Scottish block. The accusation that PPP is the only show in town is, therefore, again misplaced.

We have policies that are designed to regenerate public services. We need to respond to that heavy requirement, particularly for the environment. As a former convener of the Transport and the Environment Committee, I know that some of the demands from Europe and elsewhere with regard to investment in water and waste water infrastructures had to be dealt with.

We know about the work that is being done in education and health to deal with the Victorian schools and 1960s and 1970s buildings that are no longer suitable for use. Some facilities out there are frankly unsuitable for decent public services. The new hospitals at Hairmyres, Edinburgh and Wishaw are a testament to what the public want from their public services. Those facilities are now up and running.

We are involved in a big exercise on the PPP schools projects. I am sure that the committee is keeping a close eye on that, and interest will increase over the next wee while. Again, we are talking not just about assets but about policy and what we want to achieve. The issue is about community schools and mixed campuses for denominational and non-denominational teaching; about shared sites for primary nursery teaching; about the integration of special needs; about health being incorporated into the school environment; and about tackling imbalances and surplus buildings in our communities. The issue is not just about bricks and mortar, and that should not be forgotten.

I have been looking through some of the committee's work and some of the words that have been expressed publicly. Those that compare the total project repayments with the capital value of the assets create an impression that the venture is not worth while. Clearly, chalk is being compared with cheese. We talk about the whole-life cost of the asset and inappropriate comparisons are sometimes made, making a travesty of the additional impact that we can make on public services. It would be useful to explore some of those issues.

There are, and will continue to be, debates around the issue of borrowing rates and the profit that is involved. Political stances will be adopted about the use of private finance. I hope that the committee's work will add to the debate at a level beyond that, so that we can consider the overall impact that PPP has made, and will continue to make, in Scotland. We need to take a balanced view on those issues and publicise the arguments. It is in the public's interest to understand the debate that we are having about PPP and I welcome the opportunity to continue that public debate.

I would also like to challenge the perspective that PPP is a challenge to the public sector. PPP

has been used to develop and strengthen the public sector and to learn across the services. As the minister responsible for public services, I have been trying to emphasise that we can learn from the voluntary sector, from the public sector and from the business community. We need to be pragmatic. As someone who has worked in public services, I do not recognise the caricature that is sometimes drawn.

Since 1997, the budget has risen from £16 billion to £22 billion. That is money that is spent on public services. The number of public sector employees and public servants has grown by 16,000 in that same period; that is an average increase of more than 3,000 per annum.

PFI/PPP is not about an agenda of creeping privatisation, but about supporting and bolstering with another tool the massive amount of work that we do in the public sector. It brings other disciplines and benefits to the Scottish community.

That concludes my opening remarks. I invite questions from the committee. I am sure that we will have an interesting time. I want to put in context the role that PFI/PPP has in the Executive's agenda. It is not the only show in town; less than 2 per cent of the revenue budget and less than 10 per cent of capital spend relates to PFI/PPP. The investment that we have made in public services over the years supports that view.

The Convener: I am sure that members will have questions on a number of the issues that you raised. I will kick off. From the work that the committee has done, it is clear that PFI projects have fairly large overheads for the cost of advisers and for the work that must be done before the finance can be put in place. Does that mean that there is a critical size for PFI projects? If so, will the projects be concentrated heavily in the bigger local authority areas, on big projects and, in the health sector, with big agencies? What are the implications of that for smaller authorities and for people in other parts of Scotland?

Mr Kerr: As the convener of the Transport and the Environment Committee—you also listened to the evidence, convener—I learned that there are fairly substantial up-front costs for PFI/PPP projects. That is not to say that public procurement does not involve similar up-front costs. That is an important point. With PFI, the cost is borne by both parties, who scrutinise each other's efforts and roles. The more time that is spent on that, the better the delivery of the service through the procurement process. The time that is taken to get a project together and the money for advisers are well spent, because they should mean a better result. The procedure is a negotiated one. I know that the committee has examined that process.

We must continue to focus on the cost of advice.

We can move to a more standardised approach by learning lessons from across sectors and throughout Scotland and the UK about how to procure through PFI/PPP. My intention is that the Executive will pursue a Scotland-wide cross-sectoral approach to the overarching issues that relate to how we deal with PPP. That is important.

There are PPP projects in the Highland Council area that work well, for example in Moray. To give a figure for the critical size of a PPP project, I think that we would consider closely a project that would cost less than £10 million. That is a rough figure by which we can assess a project. As members know, we bundle projects. As the convener and I found out in the Transport and the Environment Committee, the water industry had some large PFI/PPP projects, but it also sought to bundle together smaller projects in packages. Smaller authorities have the opportunity to do that. In addition, the NHS local improvement finance trust—LIFT—project aims to bring projects together.

Although the scale of overheads that attach to smaller contracts might rule them out, other mechanisms such as standard documentation and advice can be deployed. The aggregation of projects can make them viable. There are some interesting and innovative submissions for the schools project. I cannot give views on particular projects—that would be an interesting time for the committee—but some of the submissions from rural authorities suggest that smaller projects can be done.

Alasdair Morgan: I am interested in what the minister said about the amount of conventional capital spend and the small proportion of capital spend that PPP takes up. From the evidence, it seems to me that most of the savings or claimed savings from PPP projects come from elements such as design, project management, and maintenance and transfer of risk, and not from the provision of the capital per se. The main argument from the Government in relation to the provision of capital was that it is necessary to get it off the balance sheet.

Does the minister think that that is still the case, given the proposals on local authority financing and what the Chancellor of the Exchequer said about the reduction in Government borrowing? If capital for upcoming schemes were provided in the normal way, would that stay within the Maastricht criteria and meet all the chancellor's rules?

Mr Kerr: Those are matters for the chancellor. I have not signed up to that fundamental point. I do not see PPP as a route round the public sector borrowing requirement, although it could be argued that PPP provides a bonus for the PSBR. However, in partnership with the public sector, no

matter what the relationship, PPP brings experience, discipline and a dynamic new approach to the procurement of public services. That is the view of someone who spent 15 years in the public sector, working on the procurement side and on bidding for tenders. My view is that we benefit from PPP's different approach, which involves rigorous, sound management and the transfer of risk.

You would need to ask the chancellor your question about the PSBR, which is an important consideration for him. I hope that I have clarified that the PSBR is not the key driver for me. The issue for me is the fact that, for example, Hairmyres hospital was completed before its target date and on budget, which has made additional resources available. Those are the benefits of the PPP relationship. If we spend time and effort on the procurement process to ensure that each side knows what its responsibilities are, we get an asset that is well maintained, which we might not have achieved through the traditional route.

Alasdair Morgan: It is clear that there is transfer of risk only if a project remains a PFI/PPP one. However, it could be argued that many of the private sector's capabilities, such as its ability to do things better, smarter and more innovatively, could be done by the public sector. Have you seen evidence or do you expect that there will be a transfer of experience and working methods so that, in future, the public sector will be able to do things such as project management as well as the private sector?

Mr Kerr: I hope that that will be the case. My view has always been that the private sector has much to learn from the public sector about the management, organisation and running of public services. The private sector can also learn about the impact that the public sector makes on our communities because of its service-level standards, training and the terms and conditions under which it employs its work force. During my days in cleansing, our fundamental task was to ensure that the place was clean and tidy, the bins were lifted, the streets were swept and the rubbish and waste were disposed of in an environmentally friendly manner. That was the focus. If we had had to spend our time designing depots, facilities and transfer stations, I would—to be blunt—have regarded that as a diversion from the key task.

I do not want to take the Orwellian view that two legs are bad but four legs are good. There is good on both sides in this matter. We must take a pragmatic approach. If the public sector could develop how it delivers so that we could change the risk balance of the arrangement with the private sector, I would be up for that. However, I am not sure that we are there yet. The way in which PPP is developing is a moveable feast. The

first PPP models are radically different from those that we use now. People now take innovative approaches—for example, Argyll and Bute Council's current proposals. Different things are going on out there. Councils such as North Lanarkshire Council are working in various ways with the private sector.

We need to take cognisance of that and not set hard parameters around projects. The Executive can create a valuable framework, but many of the strengths of the PPP arrangement exist at a local level. People can get together to discuss what is best done by whom. If there are moveable aspects, in either direction, concerning risks, I am satisfied that we have the experts on board who can assess that and ensure that the public sector is protected.

Mr Davidson: On that point, do you think that there should be a central pool of expertise—a public sector consultancy, if you like—that would compete with the very active private sector consultancies, some of which have tremendous experience in a particular field and can apply it to a number of projects? Would such a central unit mean that we would not have to bundle up projects to deal with them? Many of the community projects that have to be attacked cost an awful lot less than £10 million, which is the figure that you quoted.

11:30

Mr Kerr: We are learning all the time. For example, we have Partnerships UK and the Treasury. We could develop a unit within the Scottish Executive that would help us to provide advice on such matters. The health department and the finance department include large sections devoted to the issue. We need to examine how the Executive organises and supports initiatives. I want to draw the lessons that we can learn into the centre to ensure that we are providing good-quality advice.

My vision is to develop a centre of excellence within the Scottish Executive, which can provide a level of support and advice for the organisations that you highlighted. Such a unit should also be able to reach out to smaller projects that might be out there but that might be knocked out of kilter and probably made unviable if expert advice were loaded on top of them. Making such an outreach facility available to communities and organisations is a good way forward, and I certainly intend to achieve that. The matter will be discussed in the Cabinet and elsewhere, and a Cabinet paper will soon be produced on our PPP strategy. It makes sense for the Executive to deliver such an initiative, as it means that we will not have to reinvent the wheel. Moreover, the approach will reduce costs and make it more attractive for

people to think up more innovative ideas and processes at a local level. Finally, if the Executive is seen as successful and as a centre of excellence, it might reduce public concern about PPP projects.

Mr Davidson: Will such an approach not cause some tension? For a start, you will be competing directly with the private sector. Are you suggesting that the Executive should provide such a facility, even though it is responsible for approving many of the projects? Does that not smack of central takeover?

Mr Kerr: I think that it smacks of the opposite. The private sector partner—or special purpose vehicle—involved in a project might have its own set of advisers that will look after its interests. The Executive facility will simply streamline our protection of public sector interests.

The unit will form a reference point and a focus of best practice for current innovations. I do not want to remove the necessary local discussions between the two parties involved, which are one of PPP's strengths; however, the central provision of advice might reduce the need to reinvent the wheel at a local level. I repeat that we do not want to impose ourselves on local discussions between the parties—for example, the council and the SPV—that are involved in whatever the project happens to be. The decision is theirs; our job is simply to provide the best possible support at a certain level and to suggest examples of best practice.

Mr Davidson: You said earlier that you had worked on both sides of procurement in the public sector. Do you see any changes in relation to whole-life cost evaluation, which seems to be the thrust behind the argument for PPP? What is being offered now that was not offered in the past?

Mr Kerr: I hesitate to give a specific answer to that question; perhaps Sandy Rosie and Andrew Clearie can help me out. I can tell you that, on a superficial level, I see much greater innovation and a more standardised approach to the development of contracts. Perhaps Sandy can say more.

Sandy Rosie (Scottish Executive Finance and Central Services Department): I hope that I understand David Davidson's point correctly. The difference in appraisal—Andrew Clearie is better on the technicalities than I am—is the whole-life look that is being taken. That has changed the way in which people address the factors involved in the appraisal of a project. That is completely different from conventional procurement and the guidance that applied to that.

On the methodology for assessing value for money, it is sometimes forgotten that pretty much the same test is being applied in PPP projects as

is applied in conventional projects. Obviously, the detailed factors are different, but the essence is to establish the same test of whether public money is being used sensibly as applies throughout the public sector.

Brian Adam: I welcome the minister's statement that PFI/PPP is not the only game in town. That is an important point. The implication of what he highlighted is that the availability of capital from the public purse is not a constraint any more. Is that a fair comment?

Mr Kerr: I think that what I said was that that is not the primary driver for me with regard to why we use PFI/PPP.

Brian Adam: If those two points are valid, I presume that you make the determination on the basis of whether you can deliver the project to specification, on time and within budget. You drew those three characteristics to the committee's attention in relation to the Hairmyres project. All the criteria are currently being met at the £20 million-plus project that is currently under construction at the royal Aberdeen children's hospital. They are all being met through the traditional procurement method, so it can be done in the public sector by the traditional method.

What is available to PFI/PPP that will make a difference? As you highlighted, it is still a controversial area. As access to capital is no longer the primary driver and PFI/PPP is not the only game in town, what added value will we get from PFI/PPP if projects can be delivered on time, on specification and within budget by the traditional method?

Mr Kerr: You hit the nail on the head when you said that the Aberdeen hospital project was done through the traditional route. The point about any project that we undertake is that an assessment is made and there is a public sector comparator. Each project is put through the sausage machine. If it comes out on the side of being value for money for the public purse if it is done through the traditional route, that option will be chosen. In other cases, a project goes through the sausage machine and comes out the other end in a different shape, so the PPP route is chosen. The attraction is that it has come out as being better value for money for the public purse. The fact that projects can be done by either route is an important point. The reason why a particular route is chosen is because it provides better value for money.

The health projects were laid bare before the comparator when we carried out the assessment of the funding route. Four projects came out on the side of PPP and four came out on the side of the traditional funding route. Those projects provide value for money. I do not think that it can be

disputed that, without PPP, we would never in our wildest dreams have achieved what Glasgow managed to achieve in its secondary school estate in the time scale in which it managed to do it. We would never achieve the 100 new schools, the four new hospitals and the water projects that have been mentioned. We would not have got the £2.9 billion additional capital that we have gained through PPP.

Although Brian Adam correctly stated that I think that the key driver is good delivery, if the whole of the UK and Scotland were to add up their capital requirements, we would unpick what is a very sound UK economic strategy if we went to that level of borrowing. PPP brings the advantage of the projects being completed earlier. I do not think that we can be going too far wrong when the rest of the world is developing and using similar models of partnership with the private sector.

I recollect the bad old days of compulsory competitive tendering. There was a different contracting environment, in which the public sector and the private sector were put at odds with each other in a game of Russian roulette. We can benefit from the more mature relationship that the public sector now has with the private sector. The net gains that we are making are additional investment, good practice and learning across the sectors, which we discussed earlier with Alasdair Morgan.

I hope that that answer covers your point. At the end of the day, the decision boils down to the assessment and the project coming out the right end of the public sector comparator. If that happens, there is a good reason for the funding route, as it provides value for money for the taxpayer.

Brian Adam: People's concerns are probably not about what is delivered at the end of the day but about the nature of the sausage machine that makes the assessment. There may not be a detailed understanding of how the assessment is made or, in particular, of how public sector comparators are chosen. People are concerned about the fact that, in many cases, the financial margins are not great—one can almost choose the method of assessment to deliver whatever type of route one wants.

I chose the example of the royal Aberdeen sick children's hospital. It is fair to say that, for many public sector projects, the specification was poorly defined and the time scales were ridiculous—projects always overran and were always over budget. I wonder whether we have reached the point at which the perceived benefits of PFI/PPP have been realised, with the public sector delivering the same benefits without any of the private sector risks.

Mr Kerr: I do not start from the premise that we need to do everything with PPP—I am trying to express the opposite view. I start from the premise of providing value for money for the taxpayer.

The public sector comparator is not something that politicians meddle with—officials must go through a process that has been laid down by the Treasury and which determines the viability not just of PPP projects but, as Sandy Rosie said, of all projects. Members must know that the same test is laid down for all public procurement.

I am struck by another difference in how projects are handled from the way in which they were handled in my days in the public sector—the consistency of delivery. There is no political or other meddling with budgets. The arrangements for the whole-life cost are set down in tablets of stone through the contract delivery process. We know that the asset will survive the 30-year period because we have transferred the risk and the responsibility to the service provider. I remember the days when the training budget went first and the maintenance budget went next, so that the roof of the depot was not fixed, the walls were not painted and the windows were not repaired. To put it bluntly, the public sector did not look after its assets effectively. PPP brings discipline to the process and allows us to maintain the asset in a more beneficial manner. The fluctuation that can and does exist in the public sector is taken out of the scenario and so our assets are protected. Academic studies back up some of those points.

I want to engage in the debate. Do not get me wrong—when I worked in direct labour organisations, I always said that I would never protect a DLO that was bad at what it did. A DLO that was inefficient or lazy, that did not invest in or manage its staff properly, or that did not deliver properly had no right to exist. I apply that approach to any decision that is taken in the public sector.

The Convener: Can I be clear about your two messages? Is value for money in the public sector comparator the most appropriate mechanism for talking about the merits or demerits of PFI/PPP, or does service quality become one of the dominant criteria?

Mr Kerr: There is a balance. For me, value for money includes quality—quality should never be separated out. When I talk about value for money, I include quality aspects in the word “value”. Cheapest is not best.

That is how I distinguish between the word “value” and the word “cheapest”. Value is at the forefront of our considerations of the PPP process and, in my opinion, value encompasses quality.

11:45

Brian Adam: In the evidence that we have heard, costs—particularly the maintenance costs—have been cited as one of the main benefits of PFI/PPP. In circumstances in which we choose to go down the traditional procurement route, what mechanisms are we developing in the public sector to ensure that appropriate maintenance is built into the system? Is resource account budgeting sufficient for that, or should we look to other mechanisms?

Mr Kerr: I do not think that resource account budgeting is sufficient. Although it delivers in relation to certain aspects of the Executive's work, I am not sure that it can be transferred beyond that in an effective enough way. We are discussing with our colleagues across the public sector—including service providers and service users, as well as the institutions and organisations—our desire to have a body that allows us to exchange best practice in an effective manner. Down south, IDEA—the Improvement and Development Agency—is about improving and developing public services. We are looking at that model. Although we will probably not choose to go down the same route, we want to have a public sector best practice organisation in Scotland. That would enable us to reach the eventual goal in relation to the activities of the public sector and the private sector that Brian Adam mentioned.

Brian Adam: Do you believe that you can deliver good practice without the discipline of the market? With a PPP, someone else has control over the maintenance budget. Is good practice possible without that external control?

Mr Kerr: I have always believed that competition, benchmarking and best value play a key role in the public sector. Even if we manage to develop a model in the public sector that adopts the best practice of the private sector, we still need to test that model. We cannot take money directly out of people's pockets without putting such a model to the test. That is where the key difference lies in the present discussion. Even if we are able to achieve the desired level of best practice in the public sector, we will still have to test our model in the marketplace.

Mr McCabe: Capital projects have always had an impact on revenue expenditure. Increasingly, people are expressing the concern that, because of the level that PFI payments have reached, there will be an adverse impact on the revenue that is available to different clients. It is estimated that PFI payments will exceed £350 million by 2003-04. Does that represent cause for concern? Is there an appropriate balance between conventional procurement and the use of PFIs, or is that a spurious concept?

Mr Kerr: The idea of an appropriate balance is not a spurious concept. There must be a levelling in relation to where we can go, so that we do not tip over the relationship that exists between conventional procurement and PFI procurement. Together with Cabinet colleagues, members of the Finance Committee and others, I want to come to some conclusions about the relationship between the percentage of PFI capital spend and the percentage of traditional procurement capital spend. There is a limit on how far the revenue costs, which are less than 2 per cent of the Scottish pot, can go. I fully acknowledge that PFI schemes entrap one's resources over 30 years or an equivalent period.

We have not worked out what the relevant balance should be, although figures have been produced. We are considering that issue and I hope that the Cabinet paper will throw light on some of that. We want to maintain our mixed investment plan for Scottish public services. The answer is yes to both your questions, but I cannot offer you any detail about the figures.

Alasdair Morgan: I wonder whether you have contradicted something that you said earlier, when you spoke about putting public sector procurement and private sector procurement to the test and adopting whichever method comes out as best value for money. It could be that you decide to do everything publicly or to do everything privately, if that is the way that the tests turn out. Surely you cannot then impose a percentage test and stipulate an ideal balance, whereby X per cent is public and Y per cent is private.

Mr Kerr: In terms of a prudential scheme for these projects, a ceiling can be considered and it may be moveable through time and with experience. As we move down the route, for instance, of removing section 94 controls on local authority capital spend, local authorities will be expected to take decisions based on the prudential framework and to determine the balance of capital and revenue at a local level. The Scottish Executive can do that as well.

Alasdair Morgan: But the implication is that at some stage, although your tests show that one scheme would be better value for money, the prudential nature of the decision will make you go in the other direction.

Mr Kerr: The ceilings that would be set would not, I hope, lead to that scenario in the short term. As we learn from and progress our relationship with PPP, we will take clearer decisions about that relationship. Someone with responsibility for the Scottish block could take the considered opinion that we could not tie up X per cent of our resources over 30 years because it would not leave flexibility to deal with other matters. We may get to that point, but that is postulating far into the

future. Initiatives are being developed and different models are coming to the fore and being examined by us. We live in interesting times. We have to put the question, "Is it acceptable to exaggerate wildly that 50 per cent of our Scottish block will be tied up for 30 years in revenue costs for PPP projects?"

Brian Adam: If you were asked to take a stab at where the ceiling might be, where would you put it?

Mr Kerr: I will give the usual response—as you would expect, Brian—that I am considering those matters and that I will have to discuss them with Cabinet colleagues and others who have a direct interest in health, education and so on.

Brian Adam: In that case, when are you likely to come to a conclusion and to share it with us?

Mr Kerr: I hope that it will be fairly shortly, but those decisions should not be taken lightly—they are taken for a reason. I do not want to postulate too wildly at this time.

The Convener: That issue is of interest.

Mr Stone: I wish to shift the questioning slightly. In fairness, the discussion that we have had has been of tremendous interest to us all and to the chattering classes, but to people out there, there is a bill that they have to pay—known as charges—which is outwith the block. Could you outline the Executive's philosophy on those charges? Have you set notional limits? To what extent do you take into account the charges that may arise from a given project in determining whether it is a good project or a bad one?

Mr Kerr: Which projects do you mean?

Mr Stone: For example, take a water and sewerage project. There will be a charge, which the public has to pay and which is outwith the Scottish block—it is a separate revenue stream. The charge may go to councils and it may not be part of your financial considerations, but it has a direct impact on people out there. I am anxious to know the Executive's thinking. Do you have informal guidelines at your own hand? To what extent do you take possible charges and increases in them into consideration when you say yea or nay to a given proposal?

Mr Kerr: Within parameters, we devolve powers and the taking of decisions to relevant authorities. For example, we talked about local government and the prudential framework. In relation to the water industry, the water industry commissioner can determine ceilings on the industry's charging and borrowing regime. A degree of responsibility is devolved. I refer to my previous point about what we consider to be the appropriate level.

Sandy Rosie: I will comment on some other

local authority areas of control. For example, we know that councils look at their so-called affordability gap in a number of different ways, but they use money from the sources that you might expect them to use. Some authorities look to transfer what would otherwise have been their capital provision, if they no longer require it because of shifting across to a PPP scheme. That releases capital provision that they can use. Authorities may also have disposal receipts that they can use. In addition, they have conventional sources of income such as council tax.

As the minister said earlier, authorities must examine what they are trying to do and how they think they should do it. If there is support for a PPP scheme, it is for the authority concerned, as the owner of the project, to take that forward. The Executive provides guidance on the framework for PPP and on its operation as a methodology. As members know, we provide a certain amount of revenue support. However, that does not alter the fact that essentially local authorities are responsible for promoting and working out how they intend to finance schemes.

Mr Stone: I hope that you can reassure me that, were a lunatic authority to choose a scheme with charges that were much too high, the minister and the civil service would be able to advise that authority strongly that the charging regime concerned would not work.

Sandy Rosie: Because we are part-funding many schemes, we are concerned to assure ourselves that authorities have a plan for meeting their part of the bargain, however they do that. That is a direct financial interest, rather than the sort of regulatory interest that the member is suggesting. Authorities also have to satisfy others involved in the process, including private funders. For a number of reasons, not least their own prudential management, authorities must satisfy themselves of the soundness of what are long-term commitments.

Mr Stone: Are you arguing that, if a scheme were not viable, the private sector would indicate that it could not work, and that that would serve as a regulatory system?

Sandy Rosie: Any business plan would have to be presented to the markets, which would have to be satisfied that the authority with which they were dealing was capable of making repayments.

Mr Kerr: Authorities would also have to satisfy the regulatory bodies that exist in Scotland, such as the Accounts Commission for Scotland, which oversees what local authorities are up to. There is also the prudential scheme that is proposed in the white paper.

The Convener: One of the most controversial aspects of PFI is the impact that it has on staff.

Minister, recently you have spoken about staffing issues, particularly the issue of the two-tier work force. Would you like to say something about that?

Mr Kerr: The commitment has been made, and tomorrow we meet representatives of the Scottish Trades Union Congress to discuss developing our approach. The two-tier work force is much talked about, but we need clear evidence of its existence. The committee has sought some clear examples of that.

Any profit that PFI projects make does not have to come off the backs of the work force. Central to PFI are some of the other issues that we have talked about this morning, such as how we deliver innovation. I am happy to have a discussion with the trade unions. We need to provide guidance at a Scottish level that ensures that the best value of a project encompasses good relations with the work force. There is no benefit for the public or the private sector in having high staff turnover, low training, low morale and low pay, as those things do not result in a good service. We want to ensure that staff taken on at a later stage under PFI schemes benefit from the same terms and conditions that are available to people who are currently employed by those projects.

It is important to make clear that we do not want to fossilise terms and conditions. In all public and private sector services, we need to move on in terms of how we deliver. Word processors and information technology have made a massive difference, just as the wheelie bin made a massive difference to cleansing work. Things will improve and value for money will be squeezed out of innovation. This is not about fossilising conditions for people who join a project after it has been transferred and is up and running. It is about saying that people who are part of the same work force should have broadly similar terms and conditions. That is one of the work force issues that we need to address. I am sure that we can do that, because I do not think that having different terms and conditions for staff is a key determining factor for special purpose vehicles.

12:00

Mr Davidson: I would like to go back a couple of steps. One of the problems with the conventional procurement system and PFI seems to have been that PFI automatically works out to be more expensive. The difference appears to relate to maintenance and keeping building works as efficient and modern as possible, which has apparently not been done in the past. That seems to have been missed out of the argument.

One claim that is made in favour of PFI is that the private sector can bring in the right regime to design, build and operate. Has the public sector

reached that level yet? Can it deliver in exactly the same way? Obviously, such delivery includes lifetime-cost management and adequate maintenance of buildings, which appear to be risks that are promoted as a benefit of PFI. In order for public procurement to meet that challenge in head-on competition with PFI, a permanently up-to-date facility has to be delivered. Are the public agencies at that stage? We should bear in mind the fact that the project that Mr Adam mentioned was cash rich, which influenced the available choices, although the project was still delivered to the terms of the contract.

Mr Kerr: As I said in one of our other discussions, the public sector aspires to that level and may want to carry out such work. The public sector is good at delivering services on the ground. Do we want to refocus and re-engineer public services and focus on asset building and maintenance? That is not my decision to make—we devolve such decision making to a local level.

South Lanarkshire Council—which is my council and Tom McCabe's council—took a decision that was based on a best-value review. It said that it was not very good at civic amenity site management and commercial waste collection and that perhaps such things were better done out of house, using another relationship with the private sector. I want to see such mature decision making by local authorities. Perhaps authorities could get to or be at the point that David Davidson mentioned, have all the skills available, have a whole-life asset, take care of the asset and carry out all that work, but is that where the public sector wants to be? Responsible councils and other bodies will take such decisions. The public sector may aspire to such work. Public sector bodies may take strategic decisions about what marketplace they want to be in. Do they want to be in the marketplace that involves building and maintaining large capital assets or do they want to specialise in front-line service delivery?

Mr Davidson: Does that mean that your current preference is that the design and build stage is up for grabs between the two systems, but that the operate stage should be retained in the public sector?

Mr Kerr: It is down to local partners to determine their local arrangements and what they consider to be best value for money. I would not want to be prescriptive. It would be unhealthy if I started to impact on local decision making in that manner from Victoria Quay in Edinburgh.

Mr Stone: Some weeks ago, members of the Northern Ireland Assembly appeared before the committee. Their PPP commitment is not as great as is ours on this side of the water, but they were enthusiastic. To what extent do you compare notes with other devolved Administrations and

other states, such as Eire and other European countries, to test what you are doing and to find out whether you could do better? I know that you are busy, but is there a communication channel?

Mr Kerr: I read with interest what Mr Molloy said when he gave evidence to the committee. Sandy Rosie works as an officer in an integrated network and advice comes back to me. Perhaps he can say how that network works and how it impacts on my decision-making processes.

Sandy Rosie: As members probably know, there are strong links internationally and throughout the UK in respect of how PFI and PPP have developed. There is still much commonality in respect of reliance on guidance and the fact that Partnerships UK operates throughout. There is a lot of dialogue at official level on what people are doing and on what interesting things they are trying in pilots and different projects. In carrying out their review, the people from the Northern Ireland Assembly have spoken to us and were interested in what we have done in Scotland. I think that they are due to come back to see us again before too long.

Brian Adam: A lot of the debate around PPP and PFI has centred on the transfer of risk. In the early stages, it was felt that the maximum transfer of risk to the private sector was in the interests of the public. What guidance are you currently giving on the quantification and allocation of risk and the management of risk between contractors and operators on one hand and the public sector purchaser on the other?

Mr Kerr: My view is that risk is best dealt with by the most appropriate organisation in the partnership. The public sector takes a risk when it projects its estate requirements and estimates its school rolls over the next 25 or 30 years. It is legitimate for the public sector to take that risk. There are volume risks associated with assets such as hospitals and schools. However, in relation to a project such as a waste water treatment plant, the risk should be much further away and should be in the hands of the special purpose vehicle, as that would not involve a people-based risk but would be more to do with the treatment of the waste water. Various models apply: the risk associated with a road is different from the risk associated with a hospital. Legislative risk has to be assessed as well. For example, what risk is there that the raising of European standards will impact on the ability to sustain emission levels?

Although we are getting better at it, risk is hard to define. However, my view is that the sector that knows most about a particular issue should take responsibility for the associated risk. If the public sector chose to transfer all the risk, we would have to pay for that. That is, therefore, not an

appropriate way of going forward. The arrangement should be arrived at through discussions at a local level with the teams involved to negotiate how the issue of risk best fits within the financial model that emanates from the discussions.

Brian Adam: Are you saying that you are not developing a central set of guidance to indicate that in certain specific circumstances the risk should lie with the public sector and that in other specific circumstances the risk should lie with the private sector?

Mr Kerr: I think that I have addressed that point. Perhaps Andrew Clearie can be more specific.

Andrew Clearie (Scottish Executive Finance and Central Services Department): There exists technical guidance on the assessment of risk. The Treasury task force technical note 5 sets out the assessment of risk in relation to the construction of the public sector comparator, for example.

Transfer of risk does not happen by itself; it has to be effected. The contract documentation that we have—the Treasury task force's standard document and the standard Scottish schools contract that we are currently working on—have clauses and provisions within them that reflect the current market practice on the transfer of risk.

Brian Adam: So the situation is changing. Is it changing according to the market or Government direction?

Andrew Clearie: Generally, within sectors there is an acceptance of where risk should lie. For example, in the time in which we have done eight deals on schools, there has been evolution in relation to the apportionment of risk. It is now clearly accepted that certain risks lie with certain partners in the contractual relationship.

The Convener: The evidence that we have taken indicates that transfer of risk is expensive. There is an argument for trying to identify where each risk best lies and what the cost of transfer is in order to ensure that the best value for money is attained. I am not sure that that necessarily applied at the earlier stages of PFI. We might be learning lessons in that area.

Evidence that we have taken suggests that some of the earlier PFI arrangements did not adequately take account of some of the implications of refinancing, particularly in relation to the promotion of revenue sharing as a route once the risk begins to drain out. Can you tell us how you are tackling refinancing? Perhaps you could also talk about recontracting and the advice and guidance that you give PFIs and PPPs.

Mr Kerr: All those questions are linked. We are learning and therefore the questions about risk, refinancing and how we carry out the projects are

a moveable feast, as I said at the beginning. We must ensure that we are learning from the best, which is why we want to set up a centre of excellence in Scotland.

As projects move from the construction phase to the management phase, appropriate refinancing regimes come into play. I whole-heartedly agreed with the convener's comments about earlier projects that did not take proper cognisance of the fact that refinancing would happen down the line. That is why the Office of Government Commerce and Partnerships UK have undertaken work to ensure that refinancing is built in. I believe that guidance on the 50:50 split has been available for about two years.

Projects in Scotland are being called in so that refinancing can be considered. Some of those projects are reaching that target, whereas others are not. Through the learning process we will ensure that, in future, projects will reach the target that has been set—the target will be built into the process. The convener was absolutely correct to say that the earlier projects were not reaching the 50:50 target. Some projects are not far from the target and some have done well to reach it. However, as the model develops, refinancing will be dealt with.

It could be argued that recontracting is about prevailing local circumstances. There might be a requirement to recontract; for example, different or innovative ways of handling the project might be found. If so, recontracting is done on a negotiated basis. If recontracting brings value for money and the improvement in quality that we talked about earlier, so be it.

The mechanisms, specifications, legal arrangements and governing features of the project that are in place allow recontracting to happen in a much more organised way. I have been involved in procurement in other spheres in which recontracting was done haphazardly, mid-way through the process, and I know that the taxpayer paid for that. The current regime allows us to make recontracting happen much more effectively.

The Convener: I suppose that, in the context of refinancing and recontracting, we can anticipate that the construction arm of a consortium that has been set up to proceed with particular PFIs may want to realise its equity and move on to reinvest its resources in new construction projects. That might create a set of service providers that concentrate on that aspect of projects. How might that industry take shape? What role might the Executive or some of the commissioning organisations in local government or health have to play in regulating and controlling such a process?

Mr Kerr: Sandy Rosie has advised me that, at the PUK level, discussions are continuing on that subject but, to be blunt, I do not have the details.

I see the issue as being one about which local decisions can be made. There are some effective, efficient and aggressive direct services organisations and DLOs that could play a part in that process. They could submit bids at special purpose vehicle level to provide support for services, although that approach might not be appropriate for other authorities.

The other point that strikes me is that we are moving towards community planning, where there will be far greater integration of the delivery of local services in the community and where circumstances around schools, hospitals and day-care facilities might allow scope for bigger and more inventive approaches to local service delivery. That brings me back to my original point that such approaches will add value for money and quality for the taxpayer. It is early days, but you are right to identify the possibilities and potential that exist.

Mr Davidson: This morning you have talked about local decision making and local views. That takes us on to the Scottish Executive's role and the potential for rationing. This year, Aberdeenshire Council announced that the Scottish Executive had given it an opportunity to bid for PPPs for primary and other schools. There was the distinct impression locally that the Executive had given the council a time-limited window of opportunity—that was how it was put in the council's press release. Could you explain the role of the minister and the Executive?

Mr Kerr: We have bidding rounds. There were previous bidding rounds and bidding rounds will take place again. For example, another round will take place in September. The window to which you referred might simply be the current window, and another window will come along soon. It is not the end of the world if projects do not—

Mr Davidson: That is fine, minister. Let me move on to the windows of opportunity. What role does the Executive play in deciding that there will be an opportunity? What limits, such as the obvious limits in the previous round, does the Executive put on opportunities?

Mr Kerr: We make decisions based on the spending review processes whereby we allocate resources to a particular task. As members know, that spending review process is under way. We allocate according to our views on particular projects. Those windows of opportunity are open and the projects can come through them.

Mr Davidson: So you are returning to a form of challenge bidding for pockets of PFI opportunity.

Mr Kerr: One could interpret the situation that way. We also set high benchmarks and targets before people can get access to the funds. Therefore, if the project is determined not to be viable or deliverable, if it is not thought through, if the partners are not in place, or if the project is over-ambitious, under-ambitious or does not address the policies that the Executive is encouraging local authorities to pursue, it will not get money. Funding is not dependent solely on the amount of resource available.

12:15

Mr Davidson: I am encouraged that the minister takes an active role in managing the quality of the roll-out of such schemes. That has added to the evidence.

Brian Adam: I assume that the Executive has a role in that context because the Executive funds the revenue consequences of any PFI/PPP bid. That seems to run counter to the assertion that the minister made that the Executive is trying to ensure that decisions are made at a local level and that it does not want to interfere. How will the balance be struck? In relation to the smaller projects that local authorities are trying to bundle, the Executive makes the decisions about which ones go ahead, because it is providing the revenue funding.

Mr Kerr: We have always done that 100 per cent. We are saying that we are getting local buy-in by the level playing field support that we provide. It is disingenuous to say that the Executive has such control. I have said umpteen times that how such things are developed and managed at local level is critical. The schools will not be ours—the funding must be built into the local arrangement. We do not have the heavy influence that Brian Adam suggests. We have set our benchmarks, we have told the authorities that want to bid what the parameters are and what they must do to be successful and we make a judgment on that.

The Convener: Your role is no different to what it was in relation to section 94 consents.

Mr Kerr: It is better. Education authorities have to tell us what they have done in their communities to convince the communities that such projects are a good way forward for the schools estate, or whatever the project happens to be. It involves all those other things about partnership and the way forward—how it fits into other policies such as those relating to special education needs, access issues and deliverability issues in relation to denominational schools. It is about all that good stuff. It is not just about bricks and mortar—this represents policy being delivered effectively.

Alasdair Morgan: I want to clarify a point on the

education rounds. Am I correct in thinking that the forthcoming projects have to be PPP or PFI projects to benefit from level playing field funding?

Mr Kerr: Yes. They are bidding into that process outwith the usual capital funding work that we do with local authorities.

Alasdair Morgan: If a local authority wants to benefit from the assistance that the Executive is offering, in this case, PPP is the only game in town—otherwise the authority cannot bid for the extra assistance.

Mr Kerr: The usual capital budget, which has increased by 25 per cent over four years, still exists. Authorities are bidding into a restricted fund for PPP projects. However, the world goes on in relation to delivery using normal capital routes.

The Convener: One of the things that came across in the context of the Glasgow schools—I suspect that this will apply to the Edinburgh schools, too—is that instead of the bids being made for closed-contract packages, as they would have been previously in the public sector, the procurement mechanism allowed the bidders to tender variant bids that were based on output specification. In Glasgow, that meant that we had 11 new secondary schools instead of one new secondary school, because the system was more cost effective, which has been seen positively in Glasgow.

Do you think that that mechanism should be highlighted more clearly in relation to procurement practice, both through PPP and other routes? In other words, people should not be saying, “We want hospital X in place Y”, but rather “We want X kind of service” and leave it up to contractors in alliance with others to determine the best or most effective ways to deliver that.

Mr Kerr: That philosophy should pervade all that we do in the public sector. It is a key requirement of the spending review that we focus on what is delivered, rather than on inputs. I recall the old days of compulsory competitive tendering, when it was about how many workers would be provided to sweep the streets and how many vehicles or brushes there would be. At the end of the day, nothing was said about whether the place would be cleaner or better managed.

We have been moving toward outcomes in the public sector, so that we go by standards of delivery rather than by inputs. That policy should pervade traditional contracting regimes, PPP schemes and the spending review. We are not interested in the numbers, but in the service. That is the direction in which we are going.

The Convener: Thank you.

Mr Kerr: I look forward to the committee’s report.

The Convener: We will try to produce it as soon as possible.

12:20

Meeting continued in private until 12:34.

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