

FINANCE COMMITTEE

Tuesday 2 December 2003
(*Morning*)

Session 2

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FINANCE COMMITTEE

16th Meeting 2003, Session 2

CONVENER

*Des McNulty (Clydebank and Milngavie) (Lab)

DEPUTY CONVENER

*Fergus Ewing (Inverness East, Nairn and Lochaber) (SNP)

COMMITTEE MEMBERS

*Ms Wendy Alexander (Paisley North) (Lab)

*Mr Ted Brocklebank (Mid Scotland and Fife) (Con)

*Kate Maclean (Dundee West) (Lab)

*Jim Mather (Highlands and Islands) (SNP)

*Dr Elaine Murray (Dumfries) (Lab)

*Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)

*John Swinburne (Central Scotland) (SSCUP)

COMMITTEE SUBSTITUTES

Mr Adam Ingram (South of Scotland) (SNP)

Gordon Jackson (Glasgow Govan) (Lab)

David Mundell (South of Scotland) (Con)

Iain Smith (North East Fife) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Professor Alan Alexander (Scottish Water)

Donna Bell (Scottish Executive Finance and Central Services Department)

Mike Gibson (Scottish Executive Education Department)

Dr Jon Hargreaves (Scottish Water)

Naseef Huda (Scottish Executive Education Department)

Douglas Millican (Scottish Water)

Alan Sutherland (Water Industry Commissioner for Scotland)

CLERK TO THE COMMITTEE

Susan Duffy

SENIOR ASSISTANT CLERK

Jane Sutherland

ASSISTANT CLERK

Emma Berry

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 2 December 2003

(Morning)

[THE CONVENER opened the meeting at 10:01]

Education (Additional Support for Learning) (Scotland) Bill: Financial Memorandum

The Convener (Des McNulty): Good morning and welcome to the 16th meeting of the Finance Committee in this session. I welcome members of the press and public. I remind members that, as usual, they should turn off all pagers and mobile phones and I ask members of the public and witnesses to do the same. We have received no apologies for today's meeting.

Agenda item 1 is further consideration of the Education (Additional Support for Learning) (Scotland) Bill. I welcome to the committee officials from the Scottish Executive. Members will note from the agenda that Wendy Wilkinson, who is the bill team leader, was due to be with us, but she is unwell. Mike Gibson, who is head of the additional support needs division, is with us instead. He is joined by Donna Bell from the Finance and Central Services Department, Naseef Huda from the research, economic and corporate strategy unit and Jillian Boyle, who represents performance management and finance in the Health Department.

Members have a copy of the Executive officials' submission, which was issued yesterday. Members also have a letter from the Education Committee and a letter from the Minister for Education and Young People to that committee. Although those papers are of interest to us, we received them rather late in the day and members might not have had sufficient time to look at them in as much depth as they would have liked.

We also have a copy of the submission from the Scottish Legal Aid Board and a follow-up submission from the Convention of Scottish Local Authorities. As the officials have provided the committee with a submission, I understand that they do not want to make an opening statement, so we will proceed to questions.

What are the Executive's views on reconvening the financial memorandum working group to re-examine and monitor expenditure? That was one of the suggestions from COSLA.

Mike Gibson (Scottish Executive Education Department): We are happy to discuss issues that relate to the costings of the bill's provisions, but it would be unusual to reconvene the original group. We need to see what happens to the bill once it has gone through Parliament before we look at costings. We will have discussions with all the stakeholders when it comes to looking at the implementation of the bill.

Donna Bell (Scottish Executive Finance and Central Services Department): We carried out the full consultation process with COSLA and other interested parties. We also discussed the implementation process, which, depending on the way in which the bill is implemented, is where the projected costs could differ, and the consultation process that will take place during implementation to ensure that the costs are kept within the figures in the financial memorandum.

The Convener: The evidence from COSLA was that three or four meetings of the financial memorandum working group took place. From what you, COSLA and other agencies are saying, it is clear to us that there are significant discrepancies between the different parties' interpretation of the anticipated costs. Given the different interpretations, do you think that the work of the financial memorandum working group was successful?

Mike Gibson: We have seen some of the COSLA submission and there are aspects of its figures that we would like to discuss further with the organisation, because there are areas of disagreement. One of the letters that you received—the letter that was sent to the convener of the Education Committee—set out one of COSLA's misinterpretations of the bill that was introduced in Parliament in October. It is a technical point, but we feel that COSLA misinterpreted the meaning of the legislation. Perhaps that influenced its conclusions about how many youngsters will receive a co-ordinated support plan.

The Convener: My point is straightforward: the purpose of the financial memorandum working group was to look at the technical aspects of the bill and to reach an agreed interpretation of them through analysis of the costings. Judging by the evidence that we have received, that process has not worked. The fact that it has not worked makes our lives difficult when it comes to interpreting the costs properly. If one group says one thing and another group says something fundamentally different, that makes the Finance Committee's job difficult.

Donna Bell: I understand how difficult it is for the committee if you receive conflicting information. We went through the full consultation process with all the stakeholders. We also went

through all the questions about costs and the risks associated with those costs that were asked in the financial memorandum. We had three meetings, but a fair amount of correspondence went back and forth between those meetings and clarification continued to be provided throughout that period.

At the end of the process, we set out a final draft and asked for agreement, or some sort of sign-off, from COSLA and other stakeholders. The draft was passed through without any further comment, so we were surprised by the further submissions from some stakeholders.

The Convener: It is not for us to allocate blame to any agency. The issue for us is whether we believe you and your interpretation of what the costs will be, or whether we believe COSLA. COSLA has an advantage, in that, at one level, it is closer to the chalkface. You have a job to do to convince us that your interpretation is correct.

Donna Bell: The information that we used was the information that we received from COSLA and the other stakeholders in the first place. That makes it difficult to see where COSLA's new figures come from.

The Convener: To return to my original question, does that mean that the group should be reconvened so that you can reconcile the problems and we can get clarity? How do you anticipate proceeding with the situation?

Mike Gibson: There are obvious areas of disagreement between some of COSLA's figures and our figures. We saw the latest submission that COSLA made to the committee yesterday, in which it estimated that 15 per cent of youngsters—or 115,000 youngsters—would be eligible to receive co-ordinated support plans. Clearly, that is nowhere near the policy intention and, from that point of view, we feel that the figures that COSLA has produced are not accurate. I am unclear about the rationale for the paper that COSLA gave the committee yesterday. I am happy to discuss with COSLA how it arrived at the figures, but they did not seem to be subjected to any rigorous analysis.

The Convener: There are issues of interpretation here, but one of the crucial points is that the policy intention of the bill does not make it absolutely clear what is included in the figures. It would be easier to accept a quantification that was nearer to 3 per cent of eligible children if you were absolutely clear about the circumstances under which somebody would qualify for a co-ordinated support plan. However, because the reasons for the choices that are being made are not explicit, we cannot make that judgment. You can say that your intention is for the policy to cover about 3 per cent of children but unless you designate in which areas the plans will apply and in which areas people will be disappointed because the plans will

not apply to them, it becomes difficult for us to make judgments.

Mike Gibson: The financial memorandum gives an indication of the number of youngsters who are expected to have a co-ordinated support plan. We have given the figure that 50 per cent of those who have a record of needs are expected to have a co-ordinated support plan plus, above that, an additional proportion—0.3 to 0.6 per cent—of the school population. We are clear about our costings and the anticipated number of co-ordinated support plans. We are not suggesting that anything like 115,000 pupils—15 per cent of the school population—will have a co-ordinated support plan. There is a wide difference of opinion between us and COSLA.

The policy intent is clear and we feel that the way in which the bill is framed makes it clear that we do not intend 15 per cent of the school population to have co-ordinated support plans.

Dr Elaine Murray (Dumfries) (Lab): I accept that the intention of the legislation is not to create that situation. However, to be fair to COSLA, in its most recent submission to the committee it has attempted to put figures on the number of young people with particular types of difficulties who might or might not—but could—qualify for a co-ordinated support plan. The financial memorandum states that 50 per cent of those who have a record of needs will have a co-ordinated support plan, but none of us have a handle on how you arrived at that figure. We have never had an explanation of why you think that only half the pupils who have a record of needs will have a co-ordinated support plan. That makes it very difficult for us to assess whether the figure is correct.

Mike Gibson: I will ask Naseef Huda to pick up the second point, but first I will address the point about COSLA's most recent submission.

We have made it clear in all the policy papers that we do not see a clear link between putting a label on a child—whether autism or attention deficit hyperactivity disorder—and the need for a co-ordinated support plan. We have always said that it is necessary to look at the child as an individual and to determine whether they fit the criteria for a co-ordinated support plan. That is why we have some difficulties with COSLA's most recent submission. All that it does is give a list of conditions and attach percentages to them. There is no rationale about where the percentages come from or where they fit in with the criteria for a pupil having a co-ordinated support plan.

I ask Naseef Huda to explain how we arrived at our figures.

Naseef Huda (Scottish Executive Education Department): One of the questions that we asked local authorities to come back to us on as part of

the consultation process was what percentage of existing records of needs they thought would result in co-ordinated support plans, given the policy intention that Mike Gibson has outlined.

We received a range of estimates from local authorities. Some local authorities gave us estimates that were desk-based exercises, while others—in particular, South Lanarkshire—asked head teachers for their opinion. We included those estimates in our figures as best we could. Some authorities stated that 100 per cent of records of needs would result in CSPs. However, on the basis that that is not the policy intention of the bill, we excluded what we felt were outliers, and 50 per cent seemed to be a reasonable figure based on the returns that we received from local authorities.

Dr Murray: I know that the Executive does not accept that the change from an “and” to an “or” in section 2(1)(c)(i) means that the intention is different, but it certainly implies that to others.

I ask for clarification as to what is meant by section 2(1)(c)(i), which refers to:

“the education authority in the exercise of any of their other functions as well as in the exercise of their functions relating to education”.

Does “education authority” mean the council?

Mike Gibson: This is an important issue. The policy intent in the bill has not changed from the policy intent in the draft bill that was published for consultation. We still see one of the criteria for having a co-ordinated support plan being that a pupil requires a service from outwith the education authority.

Dr Murray: Do you mean the local authority—the council?

10:15

Mike Gibson: I mean outwith the education authority, in terms of the education authority exercising its education functions. You are putting your finger on the reason why we changed the wording of the bill from that of the draft bill. One of the problems is that, legally, “education authority” and “local authority” have the same meaning under the Education (Scotland) Act 1980; they are both defined as a council constituted under section 2 of the Local Government etc (Scotland) Act 1994. In legal terms, education authority and local authority are the same entity.

When the term education authority is used in education legislation, it is used in the context of the education authority carrying out its education functions. There is potential for some confusion when we use the term education authority. Does it mean education authority in terms of local authority, as you have suggested, or does it mean education authority in terms of the education

authority carrying out its own functions? The change in the wording of the bill from that of the draft bill is an attempt—members might not think that it has been a successful one—to clarify the confusion and to make clear precisely what we mean.

I refer members to section 2(1)(c)(i), which sets out the leg of the test that states that to qualify for a co-ordinated support plan there must be involvement from someone outwith the education authority. Section 2(1)(c)(i) refers to:

“the education authority in the exercise of any of their other functions as well as in the exercise of their functions relating to education”.

That acknowledges that “education authority” could in this case be taken to mean social work authority. That is why that first leg is there.

The confusion on the part of COSLA and the Association of Directors of Education in Scotland arises when we came to the word “or” after that. Section 2 continues:

“or

(ii) by one or more appropriate agencies ... as well as by the education authority themselves.”

The “appropriate agencies” are defined in section 19(2) as agencies such as a health board. By “the education authority themselves”, we mean the education authority as a local authority. That is where social work and education come in. I apologise that that is so complicated.

The intention in redrafting section 2(1)(c)(i) was to clarify what could have been a confusing situation. What has happened is that our colleagues from COSLA and, perhaps, those from ADES, have tried to reinterpret the primary legislation instead of going back and examining the policy intent. The policy intent would have illustrated to them that we do not intend any change in the criteria as to who should get a co-ordinated support plan.

Dr Murray: The confusion was also caused by the document that was published after the consultation, because it implies that a wider spectrum of pupils will be involved. We should not concentrate only on the numbers, because the issue is not only about the cost of having a co-ordinated support plan. COSLA is also worried that if there is confusion in the legislation there could be a lot more appeals. If it is not clear who is entitled to have a CSP, the cost of mediation might increase.

Kate Maclean (Dundee West) (Lab): Mike Gibson’s comments have clarified the intent of the legislation, but I do not think that they address the Finance Committee’s dilemma, which is that we have different information from COSLA and the Executive about the financial implications of the

legislation. I still do not think that the issue is clear, even after having heard how the Executive and COSLA arrived at their guesstimates. It is very difficult for the Finance Committee to make a decision on the matter without having some clarity. As the convener suggested in his first question, perhaps it would be helpful for people to get round the table and discuss the matter again.

I have seen COSLA's most recent submission only today, but I know from my constituency experience that the majority of pupils in my local authority who have conditions such as attention deficit disorder, ADHD or autistic spectrum disorders do not currently have records of needs. I suggest that quite a few of them would qualify for co-ordinated support plans. From my experience, nothing leads me to believe that fewer rather than more pupils will be covered by CSPs than are covered by records of needs. I think that perhaps more pupils will have a co-ordinated support plan than have a record of needs. Therefore, the financial memorandum does not stand up. That is only an opinion—I do not think that I have enough evidence to make an informed decision on the matter.

Mike Gibson: I appreciate the point that you are making. It has always been our intention that the code of practice will, in a sense, unpick the legislation. It is difficult to write primary legislation that gives extremely clear definitions, especially in the area of special educational needs. It is the intention of the code of practice to clarify who should get co-ordinated support plans.

The committee will perhaps be aware that, in the existing legislation on records of needs, the legal definition of who should get a record of needs is somebody who has

“pronounced, specific or complex special educational needs which require continuing review”.

I am sure that, if we were discussing that definition, members would be making similar points that the definition is unclear or that it might apply to 15 or 20 per cent of the school population. In reality, we know that that definition applies to 2 per cent of the school population, and I submit that the definition that I have just given is actually wider than the definition of those who would get a co-ordinated support plan.

The record-of-needs definition is applied to a smaller population simply because of the advice and the circulars that have been put out to clarify and explain who should get a record of needs, and the same would apply to the co-ordinated support plan. We would put out advice in the code of practice and explain in detail who should get a co-ordinated support plan. I can appreciate your difficulties with that, but to get precise definitions in primary legislation is extremely difficult.

We are no different from other countries in the western world. In Europe, the percentage of pupils who have special needs ranges from something like 0.9 per cent in Greece to 18 per cent in Finland. That does not mean that the incidence of special needs has that range, because it does not; it means that there are difficulties in interpreting who has special needs.

Kate Maclean: The point that I am trying to make is that there is no point in the legislation unless the resources are there to ensure that it works. If the legislation is to be driven by finances that have been underestimated, it will not achieve what it is meant to achieve.

I know that virtually every single school in Dundee has children who are being medicated for ADHD. A lot of them do not have records of needs although, in future, they might have a support plan. Against the evidence that I have, the COSLA figures seem to stand up better than your figures do. What concerns me is that the whole thing will be driven by cost, and the very children whom we are trying to help through the legislation will not be helped, because the resources will not be there to help them.

Mike Gibson: One would have to go back to individual cases and start to apply the test. ADHD is an example that you have used, and you are absolutely right to say that a lot of children with ADHD do not have a record of needs. A lot of children with ADHD may not require a co-ordinated support plan, because they may fail at the first hurdle of having complex or multiple factors that interfere with their learning. That is not to say that they do not have additional support needs, but many of them would not pass the severity test for a co-ordinated support plan. They may also not pass the second test of requiring significant support from other agencies. The fact that they need medication or some health support would be accepted, but I suspect that they would not pass the severity test in terms of the level of support that they require.

The Convener: The problem is that you have not really said where the severity test is actually going to cut. That is our difficulty.

Kate Maclean: I am talking about pupils who spend most of their time excluded from school because of their disability, if I can call it a disability.

Mike Gibson: As I said, the code of practice will address many of those issues, but we cannot write the code of practice until the primary legislation is in place. All that I can say is that our policy intent is clear: we do not anticipate that the number of youngsters with co-ordinated support plans will reach COSLA's estimate of 115,000. That is certainly not the policy intent, and we believe that

the code of practice can be written in such a way as to ensure that that number is not arrived at.

The Convener: I am tempted to come back on that point, but I shall let Ted Brocklebank ask a question.

Mr Ted Brocklebank (Mid Scotland and Fife) (Con): I seek clarification. When last we had witnesses here from COSLA, they mentioned that there might be special cultural needs in certain groups. Additional support for aspects of Gaelic education might be regarded as a special need, as might support for other minority languages, for all that one knows. Would not there be huge financial implications if those aspects were incorporated?

Mike Gibson: The youngsters whom we are talking about exist already, and co-ordinated support plans would be unlikely to apply to them in the numbers that we are talking about. Youngsters who require additional support for language already exist, and if they need that support they should be getting it. In a sense, the bill should not impact on them.

Mr Brocklebank: Do you believe that there might well be demands placed on the system, given the fact that many people believe that those needs have not been addressed adequately until now?

Mike Gibson: I do not anticipate that that would be an issue.

Mr Brocklebank: You do not believe that it should be?

Mike Gibson: No.

Mr Brocklebank: I will move on. Are there any other changes between the draft bill and the bill as introduced that may not have been reflected in the financial memorandum? COSLA believes that the introduction of dispute resolution is not reflected in the financial memorandum.

Mike Gibson: Dispute resolution is in the financial memorandum.

Mr Brocklebank: But is it fully reflected?

Naseef Huda: We have included a figure of up to £1.5 million for dispute resolution, but there are difficulties in estimating costs because the exact nature of the dispute resolution mechanism has not yet been fully developed.

The Convener: Could I ask about mediation and the tribunal costs? COSLA said that it believes that there is a substantial underestimation of the costs of mediation, and we had some fairly frightening figures from COSLA last week about the cost to it of the legal processes associated with dealing with tribunals, which it pitched at about twice the cost of educating a child in mainstream education. Could you comment on those concerns?

Mike Gibson: We arrived at our costings for the tribunal by looking at the system in England and Wales and taking a proportion—roughly a tenth—of those costings. From that, we arrived at an estimate of the number of appeals that we thought that there might be to a tribunal.

I am not sure that I fully understand your point about COSLA. Are you talking about officer time?

The Convener: Yes, and perhaps also any legal representation that officers might require.

Mike Gibson: We are clear that we are not encouraging legal representation. The idea behind the tribunal is that it should be family friendly and should not involve lawyers. From memory, the figure for authorities down south bringing lawyers in is quite small, so we do not see the need for COSLA to say that it would want legal representation. The tribunal should be an informal setting. There will be a lawyer in charge of the tribunal to ensure that the legal procedures are followed, and there will also be experts on additional support needs. It is not a matter of people making cases and of the outcome depending on how well a case is presented. The tribunal should have enough expert knowledge to make a judgment.

The Convener: COSLA's concern is that individual authorities will be in a position of having to convene and co-ordinate tribunals and provide representation.

Mike Gibson: No. The tribunals would be funded centrally. That would be a cost to the Scottish Administration, and there would be no expectation that COSLA would run the tribunals. The Executive would do that. COSLA would have to provide officer support and, if a case comes before a tribunal, those officers would have to appear. However, that happens a lot anyway, as some authorities already have dispute resolution and mediation and are already making an input into such arrangements.

10:30

Naseef Huda: COSLA estimated a cost of £2 million for mediation. Our best estimate was £1.85 million, but our range for the cost of mediation goes from £1.2 million to £2.5 million, so that covers COSLA's estimate. We included in the financial memorandum the costs of legal aid if families require that to prepare for tribunals or if any points of law go on appeal to the Court of Session or to judicial review.

The Convener: It is implied that the system will not be significantly more expensive than the current system.

Mike Gibson *indicated disagreement.*

The Convener: So the new system will be significantly more expensive and identifiable costs are associated with it.

Mike Gibson *indicated agreement.*

The Convener: Some of those costs relate to the running of tribunals and some of them may be unacknowledged costs to local authorities, for example for providing psychologists, head teachers and others to represent their views.

Naseef Huda: We have included the cost of about £220,000 for local authorities to prepare for and appear at tribunals.

Dr Murray: Naseef Huda mentioned the inclusion of legal aid costs. Many witnesses to the Education Committee have had the impression that parents will not be entitled to legal aid.

Mike Gibson: That is correct. The cost will arise from legal aid for going to the Court of Session, not for support at a tribunal. Legal aid might be available for discussions before a tribunal or to deal with an appeal to the Court of Session.

Fergus Ewing (Inverness East, Nairn and Lochaber) (SNP): Our job is to assess how much the bill will cost. The problem is that many of us feel that the bill will cost considerably more than your estimate. Does Mr Gibson accept that he has admitted that there is a discrepancy between the aims and definitions in the policy memorandum and other documents that have been provided to us and the provisions of the bill?

Mike Gibson: I do not think that I have said that. I am not sure what point you are making.

Fergus Ewing: Okay—you do not accept what I said.

I ask you to look at your submission, which we received just yesterday. The third paragraph on page 3—I think that it is page 3, but the pages are not numbered—is headed “Criteria for a Co-ordinated Support Plan”.

Mike Gibson: Is that paragraph 12?

Fergus Ewing: Neither the pages nor the paragraphs are numbered in the document that we received yesterday, which does not make the situation easier.

That paragraph says:

“The Executive remains clear that the policy intention is for CSPs to be for those with most complex or multiple needs who require significant services from outwith education, either through other functions of a local authority or through functions of other organisations, to support their learning.”

I will park the merits of the argument and consider purely the implications of the wording for finances. You say that the Executive plans, intends, and has always intended, that CSPs should be for people

with “most”—that is the superlative out of the words “some”, “more” and “most”—complex or most multiple needs. Where does the word “most” appear in the bill?

Mike Gibson: The word does not appear, but the submission from which you quote is a policy document that explains the policy intent. The submission does not quote directly from the bill. The bill says that a youngster will have a co-ordinated support plan if a complex factor is likely to have a significant adverse effect on their school education. We do not use the word “most” in the bill, but we speak about complex or multiple factors that

“are likely to continue for more than a year”.

Fergus Ewing: The issue is a matter of strict interpretation and the point is significant. As Dr Murray said, the bill contains a definition of co-ordinated support plans. Section 2, which provides the definitions, refers to

“one or more complex factors, or ... multiple factors”.

The word “most” is not there.

Mike Gibson: That is true.

Fergus Ewing: Many people will have complex factors and many people will have multiple factors but, just yesterday, you said that we should consider not the people who are defined in the bill, but only the people who have the “most complex” needs. You must accept the ordinary meaning of the English language. You refuse a working group and your colleague Donna Bell says that the costs will be determined once the bill is implemented. The courts will consider the wording in the bill, not the wording in the policy memorandum or any other documents. If your colleague’s admonitions are borne in mind, are you saying that you forgot to put the word “most” in section 2 and that you will go away and put it in now?

Mike Gibson: No.

Fergus Ewing: How will you reconcile the confusion? Carers Scotland says that one in five children and young people in Scotland could—rightly—qualify as having additional support needs. They might include young people who have a sight or hearing impairment, who are bullied at school, who have autism, dyspraxia or any of the other needs that COSLA was right to identify and who, in the wider sense, have “a barrier to learning”, as paragraph 2 of the Executive’s policy memorandum says.

Paragraphs 4 and 16 of the policy memorandum make it clear that the Executive wants to extend the legislative framework to encompass more children. Everybody agrees that that aim is desirable, but the problem for parents of children who will now be recognised as having needs that

require to be addressed is the cost of the system that the bill will establish. The system is complex—it involves a new tribunal, a new bureaucracy and, under section 10, the possibility that an education authority will have to request information for every parent, or child who is not of nonage, who makes an application. A large volume of new applications with a new range of costs is possible. To a greater or lesser extent, we are all concerned about that.

The simple problem is the discrepancy between the definitions in the bill and what you have said on your second or third attempt: that the intention is that those with most complex needs—not some needs, or more complex needs—should receive CSPs. Surely the bill is defective and the Executive should rethink it. I hope that Mr Gibson will respond to my general point.

Incidentally, I hope that the Executive will produce the definitions that relate to section 7(4), as that would let us know what a co-ordinated support plan is supposed to contain. At the moment, it is a blank sheet of paper. Will the Executive go back to the drawing board, re-institute the working group, redraft the bill and tell us what section 7(4) and the other blank pages to which the bill refers are about?

Mike Gibson: Some of the comments that have been made are unfair. I explained that much of the detail about co-ordinated support plans will be in the code of practice and in regulations. That detail will be developed in conjunction with stakeholders, including the people who will implement the plans.

We are making too much of the phrase “most complex” in the 12th paragraph of our submission in comparison with the policy intention in all the other documents and in the bill. The policy documentation that accompanies the bill and the financial memorandum are clear about the number whom we expect to have co-ordinated support plans.

The Convener: The problem is that the bill establishes a loose enabling framework that will allow the bar to be set at several different levels. Where the bar will be set is not clear to the committee. The implications for local authorities will depend on where the bar is set, so we are in a difficult situation.

Mike Gibson: As I said, writing precise prescriptive details about the subject in primary legislation would be impossible. To set the bar, as the convener put it, we have suggested in the financial memorandum our thoughts about co-ordinated support plans.

The original policy intent and the reason for there being a CSP in the first place resulted from our consultations on the earlier draft. A record of needs was for children with pronounced specific or complex needs that required to be continually

reviewed. During the consultations, some parents were concerned and still wanted a statutory plan. Currently, records of needs apply to around 2 per cent of the school population—it was never intended that CSPs would cover anything like 15 per cent of that population, which COSLA has suggested. The intention was to ensure that a plan would be in place for children with complex or multiple factors, which takes us to the criteria in the bill. That was where CSPs came from and why the policy intent sets the bar—as the convener put it—where the financial memorandum states that it should be set.

Fergus Ewing: The onus is on the Executive to argue for changes in the law and to explain what the changes will do. Currently, most or many children who have special educational needs have a record of needs, but under the new system, a far greater number of children and young people will have additional needs—I think that that has been admitted. However, only a proportion of those children and young people will have a CSP. That is your assumption. Perhaps slightly more children will have a CSP than have a record of needs, but the figures are roughly the same—the annual figure is given as £7.3 million, as opposed to £6.7 million, according to the financial memorandum. A new category of children with additional needs will be created. Under section 10, they or their parents will be able to say to the education authority that the child “has additional support needs” or

“requires, or would require, a co-ordinated support plan”.

If the application is made, all that the child or parent has to do is to ask for advice and information and the authority’s duty will be to seek and obtain all sorts of advice and information. That will be a complicated process in itself, as it will have to be done professionally; it will involve obtaining complex reports and it will have considerable costs.

In short, the result of the bill will be that a far wider group of children will, quite rightly, be recognised as having additional needs. In turn, it seems that that will generate a market and appetite for those children’s needs to be further recognised through a CSP. That is why I suggested when we discussed the bill at a previous committee meeting, Mr Gibson, that the problem with the bill is that the costs involved might be many times greater than you have estimated them to be. You mentioned a figure of 2 per cent, but Carers Scotland and COSLA talked about 20 per cent and 15 per cent. The multiple could be 10 times as much. As I pointed out at that meeting, that is exactly the same multiple by which the actual costs of the Holyrood building have so far exceeded the notional estimated costs of some years ago.

Mike Gibson: We do not recognise those figures. Did you say that 20 per cent was mentioned in a Careers Scotland paper?

Fergus Ewing: I mentioned a Carers Scotland paper.

Mike Gibson: I have not seen a paper from Carers Scotland—I thought that there was a paper from Careers Scotland.

Fergus Ewing: I am sorry—the committee had a paper from Careers Scotland, which suggested that 20 per cent of children and young persons may have additional special needs. COSLA's supplementary paper said that 15 per cent could require a CSP. There is, therefore, a huge discrepancy between your figures and their figures. Not only have you not answered the question, but you have refused to recognise that there are any problems at all with the bill. As far as you are aware, there are no discrepancies. You will not reconvene the working group. You think that things will be all right on the night once the Parliament passes the bill and that we will just hit and hope. That seems to be the situation.

The Convener: I do not think that Mr Gibson said that he would not reconvene the working group.

10:45

Mike Gibson: Fergus Ewing has made many points. I saw the Careers Scotland paper only yesterday, but I think that it mentioned that 20 per cent of young people have special educational needs and that it arrived at a cost of around £10 million for careers support. That was the first time that we had seen those figures. I am not sure where Careers Scotland got the figure of 20 per cent from. Many years ago, a statement that was circulated from the Warnock report suggested that, at any one time, 20 per cent of pupils in the system might have special educational needs. However, many of those needs are very mild and transitory and will not need any significant support.

There is a new label in respect of additional support needs, but we are not creating a new group of children. Children with additional support needs are out there and are being provided for. The bill intends to pull in under one piece of legislation much of the provision that is already being made for youngsters who have ADHD, for example, which was mentioned. Those youngsters might not be seen as having special needs if they do not have a record of needs. The bill clarifies matters in an innovative way and applies a label and terminology to a host of youngsters who are already in the system and being supported; it also gives some coherence to how people should make decisions about how those youngsters require provision.

The Convener: The bill establishes a framework. From a local authority's standpoint, the difficulty is that that framework will give a series of rights to parents and a system through which they can work.

Mike Gibson: That is right.

The Convener: The issue for local authorities is whether they have the resources to deliver what the framework will require them to produce. Further issues are what the impact will be on the education of other children who do not come under the rubric in question as a result of any resource implications from the implementation of the bill and whether it is known with sufficient clarity to whom the bill will apply. In particular, that final issue is a big problem for us. As you have not defined to whom the bill will apply and how it will be applied—where the bar will be set, to use my earlier expression—we cannot judge properly what the financial implications will be.

Mike Gibson: I want to go back to the definitions in the bill. I have explained that it is near-nigh impossible to give a precise and prescriptive definition of additional support needs, for example. The purpose was that an element of interpretation would be required by the professionals who work with children—that was fully intended from a policy point of view. The greatest discrepancies in our discussions so far seem to lie in the number of youngsters who will get a CSP. There are two sets of figures. The committee has a figure of 15 per cent from COSLA, and our proposed figure, which is much smaller. All that I can do is refer members back to the financial memorandum and to the policy intent about what we mean by a CSP and who should get one. Youngsters in the latest document from COSLA, for example, are certainly not covered. If a child is looked after by a local authority, that does not mean that they will require a CSP.

I appreciate the committee's difficulty. We are saying that the final interpretation of the bill will, in a sense, depend on the code of practice. However, I have indicated where the policy intent lies in respect of the number of those who should get a CSP. We are not creating new groups of youngsters—the youngsters are out there and are being provided for.

The Convener: With respect, that is not the point. The issue is that the framework that will be established will ultimately be determined by the courts or other agencies. That is the problem. If a framework were introduced that the local authority could manage, I presume that it might have some leverage on the costs, but a framework that is driven by parental claims for support services with a legal mechanism that will allow them to enforce those claims—that is the framework that you have adopted—is different.

I do not necessarily disagree with the framework that you have adopted—I am simply saying that there are certain logical consequences, one of which is that costs cannot be controlled unless one defines clearly to whom the framework will apply, which has not been done in the bill. We are in a catch-22 situation. As Fergus Ewing pointed out, there is a gulf between the policy intent and the mechanisms that exist for exercising financial control over its application.

Naseef Huda: What I am about to say will probably not answer that point directly, but I want to clarify that we asked local authorities specifically what percentage of the school population would eventually receive a CSP. None of them said that it would be as much as 3 per cent—all nine authorities that responded said that it would be less than that. None of them gave the figure of 15 per cent. Based on the returns that we received from local authorities, I do not recognise the figures that COSLA is providing.

The Convener: That is like putting your finger in the air to see which direction the wind is coming from. You have not piloted the system, so you do not have a firm view.

Jim Mather (Highlands and Islands) (SNP): How do you plan to reconcile COSLA's and Careers Scotland's interpretation of the bill's resource implications with yours? How do you plan to satisfy COSLA's call for more detail about the criteria, without reframing the bill?

Mike Gibson: This is about unpicking the definition that is contained in the primary legislation and giving detailed advice. We have set up an additional support needs advisory group, which is chaired by a senior civil servant and involves COSLA and other stakeholders, to examine the issues that Jim Mather raises. We are considering what a co-ordinated support plan might look like, what advice might sit alongside a CSP and how a CSP should be drawn up. We are already examining the criteria for CSPs.

Those are preliminary steps. To give us an idea of what will happen, we are holding discussions with the people who will implement the bill. We have already started the process. Once the bill is passed and we enter the implementation phase, the intention will be to involve people fully in drawing up all the advice and guidance that will be required to implement the legislation. We are discussing with people what a co-ordinated support plan might look like and we have started to consider to which children a CSP might apply.

The Convener: We have a number of other questions, but it may be better for us to pass them to you in writing.

Mike Gibson: That is fine.

The Convener: Members do not want to ask any further questions today, so we will proceed in the way that I have outlined. We will need a response from you by about this time next week, if possible. Thank you for your evidence.

Scottish Water

10:54

The Convener: Agenda item 2 is our investigation of Scottish Water. I thank the committee reporters, Jim Mather and Jeremy Purvis, for the work that they have done on behalf of the committee. Members have received a copy of a paper that the reporters have prepared, which summarises the issues that emerged from a successful meeting that they held with stakeholders.

To help us in our consideration of those issues, we are taking evidence today from both the water industry commissioner for Scotland and Scottish Water. First, we will take evidence from Alan Sutherland, who is the water industry commissioner for Scotland. He is accompanied from the Office of the Water Industry Commissioner for Scotland by John Simpson, the director of cost and performance, and Katherine Russell, the director of corporate affairs. I ask Alan Sutherland to make a brief opening statement, which will be followed by questions.

Alan Sutherland (Water Industry Commissioner for Scotland): Good morning. My role, which is clearly defined in statute, is to promote the interests of customers. That is what we try to do. We do it by responding to requests from Scottish ministers for advice on the level of charges that the industry needs to receive from customers in order for it to be funded properly and sustainably, for current and future customers.

In compiling that advice, we take account of information with which we are provided—for example, on the levels of service that Scottish ministers want customers to receive and on the levels of investment that, following consultation, Scottish ministers determine are appropriate for the industry. We advise ministers on the technical question of how much money is required, given the information with which we have been provided. Ours is a technical, advisory, financial role. The aim is to ensure that customer interests, both today and in the future, are protected.

Jim Mather: What could have been done to reduce the severity of the recent rises in water charges? In particular, why is there such a massive difference in planned borrowing between the strategic review that you published in November 2001 and the Scottish Executive's annual expenditure report, which was published in April 2002?

Alan Sutherland: I will deal with the second part of the question first, as it is technical.

In the commissioning letter, we were given public expenditure limits that we were told were absolute maxima. That was confirmed to us in discussions that we held with officials. We were also asked to ensure that the risk of exceeding those limits be quantified and minimised. Because the efficiency targets with which Scottish Water had been charged were challenging, a margin was left so that, in the event that Scottish Water fell short of the targets, public expenditure limits would not be breached. That is how the advice was constructed. A fairly full and detailed risk analysis is attached in the review that was provided to ministers. In essence, the level of borrowing was set within that framework.

The second factor in setting a level of borrowing for Scottish Water was to ensure that the financial ratios with which Scottish Water would operate were brought to a point at which costs that should have been paid by the current generation were not offset on to future generations. We were trying to bring cash-flow cover of interest payments to a ratio of 1. To put that in perspective, in the past five years only two companies in the industry—in one year each—have had cash-flow cover of less than 1.

11:00

Jim Mather: I am still not satisfied that we have an answer to why there is a massive difference between planned borrowing and actual borrowing. I am convinced that increased borrowing would have reduced charges. We say that the current generation is paying for gains for future generations but, in essence, we are paying for a backlog of failed investment. In that climate, is the difference between planned borrowing and actual borrowing right?

Alan Sutherland: The level of borrowing is based on what is affordable for Scottish Water. In its first year, even with an underspend in its capital programme, Scottish Water has insufficient free cash flow to pay its interest bill, which means that, at the moment, it is borrowing to pay interest. The considerable level of inefficient spending of resource means that the debt that can be supported from Scottish Water's revenue must be reduced relative to what would be the case in a fully commercial environment.

Jim Mather: Your strategic review states:

"The significant increase in investment, even after I have adjusted the timing of projects, requires both an increase in charges and full use of all of the available public expenditure",

However, *prima facie*, it looks as though you have not made full use of the available expenditure.

Alan Sutherland: With respect, we did make full use of it. We had to ensure that, if Scottish Water were to fall short of an efficiency target, the public expenditure maxima would not be exceeded.

Jim Mather: If we look back at the issue, that absolute limit seems contrary to the HM Treasury advice that was then in operation. Under the existing transitional arrangements, non-cash items would not be included. You had scope to move towards a real borrowing limit, not the one that you imposed on the industry.

Alan Sutherland: When resource budgeting was introduced, the Scottish Executive organised seminars that were conducted by Treasury officials, who explained to us in detail exactly how we should calculate the resource budget and how we should compare it with the public expenditure figures with which the Scottish Executive provided us in the commissioning letter. We did that completely and accurately. We calculated the numbers exactly as we were instructed by the people who were responsible for resource budgeting.

Jim Mather: If any of the businesses or individuals that have been hit by high charges bought a derelict house and tried to build it up, they would not pay two thirds of the capital cost of the refurbishment from revenue. Such a move would put businesses out of business and would inhibit the average household income. The limit beggars belief, given that there is scope to borrow more.

Alan Sutherland: The point is that there is not scope to borrow more, given the financial coverage that Scottish Water has available. In its first year, Scottish Water does not have sufficient cash, without borrowing, to meet its other commitments and to cover its interest.

Jim Mather: What do you mean by financial coverage?

Alan Sutherland: I mean free cash-flow cover of interest.

Jim Mather: Yet only about 15 per cent of Scottish Water's operational costs are interest payments.

Alan Sutherland: Yes, but the other costs still have to be met and the interest costs can be met only after the other costs have been met.

Jim Mather: So you are saying that none of the variables can be adjusted to produce a better outcome for the water charge payer.

Alan Sutherland: That cannot happen in the medium to longer term, or even in the short term.

Jim Mather: I find it amazing that there has been no lateral thinking to try to produce a mechanism that might ameliorate the situation.

The average householder would ameliorate such a situation by taking a mortgage and the average business would do so with a business loan, yet you tell me that that is impossible for Scottish Water, which means that the present generation will have to pay for the underinvestment.

Alan Sutherland: The example of a consumer who buys a new car—which is a standard purchase for which a consumer would borrow—is not a relative comparator, because Scottish Water needs to make on-going investment in the industry at the present levels for the foreseeable future. There is no prospect of a diminishment in the investment spend of £400 million to £500 million a year. Every year for as long as I will be on the planet, Scottish Water will have to spend a similar sum of money; if it does not, the level of service to customers will get worse, or environmental or public health compliance will go down.

Ms Wendy Alexander (Paisley North) (Lab): The non-technical among us—I count myself as one of them—are trying to clarify the issues of accountability. That said, I have sympathy with the desire for a prudent regime, given the challenges that Scottish Water faces. You said that the commissioning letter gives limits that were absolute maxima and that the injunction from the minister was that the risk of exceeding them should be quantified and minimised and a margin left so that if Scottish Water fell short, public spending limits would not be breached. That measure makes sense and is absolutely clear—I presume that it falls within your technical, advisory and financial role.

You then introduced a second consideration, which was financial coverage ratios and free cash-flow cover of interest. You think it appropriate that the ratio should be 1. Was there any ministerial direction on the need for the financial coverage ratio, or did the matter fall to your discretion in your technical, advisory and financial role?

Alan Sutherland: There was no direction on that matter. If I am to ensure that customers today and in the future pay only the costs of the service that they receive, a coverage ratio of 1 is appropriate. To put the matter in perspective, we have examined the operation of the 10 water and sewerage companies in England and Wales in the past six years. The coverage ratios there—for interest plus dividends, which is a more challenging target—fell below 1 in only two instances. Those were Wessex Water in the last year of its ownership by Enron, and RWE Thames Water in the year after its takeover by the German multi-utility company RWE. In both those cases, the ratio was driven by dividend payments to the parent owner rather than interest.

Ms Alexander: I stress that I have sympathy with the prudent view that was taken and that I am

simply trying to locate who made the decisions. In choosing a financial coverage ratio of 1 for the reasons that you have outlined, was there any reference to either officials or ministers about the impact that the ratio would have on absolute borrowing limits?

Alan Sutherland: No, but I want to make it clear that the interest coverage ratio of 1 was a target that was desired to be achieved by 2005-06. We have phased the flows in the use of borrowing and revenue to reach that target in 2005-06, assuming that Scottish Water achieves all its capital and operating efficiency targets.

Ms Alexander: I have one final question on the issue. You said that the Executive publishes the absolute maximum of borrowing and I understand that the Executive imposed the criteria that the risk of exceeding maxima should be quantified and minimised and that a margin should be allowed. You then judged, appropriately, that a financial coverage ratio of 1 was required, which would account for a further reduction in the absolute maximum of borrowing.

Alan Sutherland: Sorry, but I did not. For the first three years, we used whatever maxima of debt that we could to phase in increases and reduce the immediate up-front increase for customers. We allowed more debt early on in the period than we allowed later.

Ms Alexander: It would be helpful for the committee if you could give a rough estimate of the extent to which the departure from the absolute borrowing maxima was represented by the ministerial injunction that risk should be quantified and minimised and the extent to which it was represented by the choice of financial coverage. I am looking just for rough orders of magnitude.

Alan Sutherland: I will be happy to prepare a paper on that.

Ms Alexander: I want to push you on that. The issue has recently been a matter of large public controversy. The published maxima and the borrowing limits that you passed on to Scottish Water are well known and in the public domain. Therefore, I cannot believe that it is not possible for you to give a verbal indication of the portion of that that was accounted for by ministerial direction and the portion that was accounted for by the decision that was made about financial coverage.

Alan Sutherland: We allowed for the maximum amount of borrowing that we could while leaving ministers with confidence—a less than 2 per cent risk—that Scottish Water would exceed its public expenditure target. We used the absolute maximum within the capped maximum.

Ms Alexander: Sorry, will you repeat that?

Alan Sutherland: We allowed for the absolute maximum amount of borrowing that was consistent with the direction from Scottish ministers to minimise the risk of breaching the public expenditure limit.

Ms Alexander: I thought that we had established that you had also taken a view about a coverage ratio, which was not a direction from ministers, even though it was probably wholly appropriate and consistent with your technical and financial advisory role. However, I want to establish—

Alan Sutherland: That was to be achieved by the end of the period.

Ms Alexander: Sure, I understand that the target was to be achieved progressively over the period. However, I ask that you give some indication of how much of the gap between the absolute maxima published by the Scottish Executive and the figures that you subsequently passed on was a reflection of the ministerial direction that risk should be minimised and how much of it was accounted for by the financial coverage ratio decision that you took. As I have said, I in no way prejudge the wisdom of that decision, for which you have made a strong case, but I am trying to get a handle on the order of magnitude. We know that there was no reference of that decision back to ministers. That may be wholly appropriate within the existing accountability framework, but the committee's responsibility is to have a sense about where accountability and choices lie.

Alan Sutherland: In the final year of the four-year period, there would have been an amount of borrowing that could have been used that was not used. In other words, we could have gone to a coverage ratio of 0.8 or 0.9 in 2005-06 and then got to 1 in the first year of the next review period.

Ms Alexander: We have established that two assumptions were used to establish what Scottish Water could borrow. I am trying to establish—

Alan Sutherland: A rough estimate would be perhaps 2 per cent to 3 per cent of the total revenue level in the final year.

Ms Alexander: I was not asking for the revenue figure. I am trying to account for the discrepancy or difference between the borrowing levels that the Scottish Executive gave and those given in the review. Ministers imposed one criterion, which was that you should quantify and minimise risk. That was why a margin was left, as you said. I want to establish what the order of magnitude of that margin was vis-à-vis the margin that was imposed by the financial coverage ratio.

Alan Sutherland: It was something in the range of £20 million to £40 million in the fourth year of the review.

Ms Alexander: And what was the order of magnitude for the financial coverage ratio?

Alan Sutherland: That is the range £20 million to £40 million.

Ms Alexander: And the risk margin?

Alan Sutherland: In the final year, the risk margin would have been about £60 million.

Fergus Ewing: I have had the benefit of the analysis by the economists Jim and Margaret Cuthbert. Their argument refers to the commissioning letter of 21 August 2001 that was addressed to you. I presume that that letter was drafted by Mr Finnie's department, not by your department.

Alan Sutherland: The letter was certainly not drafted by us.

Fergus Ewing: The commissioning letter contained two errors. I am a simple soul, so it took me some time to understand what those errors were, but the upshot of them seems to be that, contrary to what we have just heard from you, Scottish Water could have borrowed substantially more. Therefore, either the charges to business and domestic water charge payers could have been much lower or the investment could have been much greater or quicker. That technical question has a practical upshot that we are all interested in.

First, why is there such a massive discrepancy between the planned borrowing given in the strategic review and that given by the Scottish Executive? For example, in table 32.4 on page 304 of the "Strategic Review of Charges 2002-2006"—a document with which I am sure you are familiar—borrowing is £102 million, whereas the Scottish Executive figure is £260 million. That is nearly £160 million more. How do you explain that discrepancy?

11:15

Alan Sutherland: I cannot comment on the Scottish Executive's borrowing figures. My job is to take the instructions and remit that I am given by ministers and to provide advice in line with the provisions in the legislation.

Fergus Ewing: Is the answer not that the Executive made a mistake in the commissioning letter? I hope that I am not misrepresenting the two economists—far be it from to do that—but they have identified a mistake. What the mistake boils down to is that the commissioning letter from Mr Ross Finnie in effect double counted the actual spend on infrastructure renewal because it treated it as both a capital asset and an expense. The mistake was to add together resource and capital budgets, contrary to Treasury advice.

Alan Sutherland: I can say only what I have already said. When the system was changed and we were asked to compile advice on the basis of resource accounting, Treasury officials conducted a seminar in which they explained how we were to calculate the public expenditure numbers that we were given. Questions were asked for clarification and we conducted the analysis exactly in line with the advice from the Treasury officials. That was checked several times with Scottish Executive officials during the process of conducting the review. At no time, either during that process or subsequently, did anyone suggest that the calculations were done in any way other than in absolutely full accordance with the instructions that we were given by ministers.

Fergus Ewing: As one who is occasionally adept at not answering questions, I recognise when a question has not been answered. You have referred to the discussions that you had with officials. What I am referring to is the commissioning letter, a copy of which I have in front of me.

I have said fairly clearly that I think that the mistake was made by double counting and that the failure was that resource and capital budgets were added together. Ross Finnie's letter refers to the capital budget in 2002-03 as being £314.3 million plus profit. Is not that a mistake? Once you deduct profit, you are left with double counting. Is not that a mistake? It is not in accordance with the informal discussions that you had with the Treasury officials.

Alan Sutherland: It is my job to calculate exactly in line with the policies that are established by the Treasury and the Scottish Executive. It is not for me to question those.

Fergus Ewing: With respect, sir, I would seriously question that. If a mistake has been made by the Scottish Executive in setting the baseline borrowing limits for Scottish Water, that affects you directly, because you must operate within the framework of Treasury and Executive policy. If the Cuthberts are right, the commissioning letter seriously understated the amount of borrowing, which had a serious impact on everything else, including the level of charges and/or the level of investment. I put to you again the fairly simple question that I put to you before: is it not the case that there was a mistake in the application of the Treasury rules in the commissioning letter of 21 August 2001 from Mr Finnie? Yes or no.

Alan Sutherland: With respect, that is a question not for me but for the Scottish Executive and/or the Treasury.

Fergus Ewing: If you are the customer's champion, surely it is a question for you.

The Convener: Hang on. I think that there is an issue here. A question for the Scottish Executive should be asked of the Scottish Executive. The Scottish Executive has responded to that.

Alan Sutherland: May I please make another point, convener? Had the borrowing constraints been different, we would have looked again at the profile, but if the assumption is found to be correct that it is prudent and in the customer interest for us to get to a situation in which interest coverage reaches 1, which means that there is no repayment of principal, just on-going maintenance of the proportion of interest payments on the whole, revenue over the period would still have been the same. Whether the borrowing constraint is there or not is not really the issue.

Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD): I will return to the area that the committee is considering first of all, which is the major issue of accountability. You have a statutory regard for customers in Scotland. In your mind, or in your office's mind, is there a weighting of what is in the interest of the customer in respect of the charges that they pay on the services that they receive? The customer interest includes customers' financial interest in paying bills and their interest in the services that they receive. Do you use such a weighting? Is it possible to have such a system?

Alan Sutherland: I am sorry, but I am not sure that I understand the question.

Jeremy Purvis: I am asking about the balance between the charges that a constituent of mine pays for their water bill and the quality of the services that they receive from Scottish Water.

Alan Sutherland: The level of service that customers receive is defined by the Scottish Executive's quality and standards process. Ministers discuss various options for levels of investment and the consequential levels of service to customers. They consult on the options and, following consultation, tell me what level of investment and outputs is required. The only input that I have once the consultation is complete is to consider the opportunity for greater efficiency in the delivery of capital outputs.

Jeremy Purvis: As a commissioner for the public, do you not think that the system is skewed? You are instructed on decisions that are taken elsewhere, but you are the guardian of the customer interest.

Alan Sutherland: We are involved in the process of preparing the various options and we engage with market research and research on priorities, willingness to pay and surveys of that ilk. Of course, like other consultees, we responded to the Scottish Executive's consultation on levels of investment.

Jeremy Purvis: I will return to the issue of charging in a moment.

Many people have been in touch with us about the quality of the consultation. To arrive at a meeting and make a presentation on a decision that has been taken is not consultation. How active is your consultation? You talked about market research—the Office of Water Services has done that in London. Is there active consultation with all business users, including small and large users and special interest groups?

Alan Sutherland: Let me tell you about our consultation processes. We have a large user group, which is a fluid membership group of between 10 and 12 of the businesses in Scotland that pay in excess of £100,000 a year. We have a twice-annual consultation with organisations including the Confederation of British Industry, the Federation of Small Businesses in Scotland and Scottish Engineering. We undertake the market research that we talked about earlier. We hold at least one annual meeting with the Scottish Consumer Council. We also have a series of public meetings to which all local community councils, local officials or whoever are invited. On average, there are about three of those meetings every two months. They are held all over Scotland: in the past three years, we have been to every local authority area at least once.

Jeremy Purvis: I was at one in Melrose. I am not sure whether you remember that I was there.

Alan Sutherland: Yes.

Jeremy Purvis: My observation of the meeting is that it was a presentation of the decision that had been taken rather than an active process of consultation on future decisions. As you may have seen from the committee papers, some of the stakeholders who have given evidence say that they want a more active process, in which they can contribute to forward decisions.

As a committee that has regard to the spending of public money, we are concerned about the quality of the decisions and about your ability, as the commissioner, to make decisions. Are you happy with the consultation process?

Alan Sutherland: It is entirely reasonable to say that all consultation processes can get better with feedback. We are happy to take that comment on board and we will try to discuss it.

Jeremy Purvis: We will discuss proposals for a consultation code with Scottish Water. Do you operate under such a published code?

Alan Sutherland: No.

Jeremy Purvis: Is there scope for you to do so?

Alan Sutherland: Yes, I suspect that there could well be.

Jeremy Purvis: The reason why I ask whether you play an active part in the consultation is that conclusion 6.3 of the water customer consultation panels' report "Principles for Charging for Water and Wastewater", which you have probably seen, says:

"a full public consultation exercise over the principles of charging should be conducted at the earliest opportunity."

Do you agree with that? At what stage in the process of making future decisions on charging should consultation take place?

Alan Sutherland: It has always been our intention to ensure that there is full and proper consultation on charging and for that to include full and proper information on the costs that individual groups of customers place on the system. It is important in any discussion of who pays what to understand who costs the system what. A reasonable balance has to be struck in terms of cost reflectivity.

Obviously, certain decisions are properly the prerogative of ministers and the Parliament. One example is whether to link domestic household bills to council tax bands. Inevitably, that decision would involve a degree of cross-subsidy by the industry. It is important that there is a proper understanding of decisions and of the costs that have to be met by other customers.

Jeremy Purvis: As a committee, we scrutinise the work of ministers. There needs to be confidence in the decisions that they take and how they come to their conclusions. I corresponded with you about one of my constituents who has a water charge of 61p on a council tax bill of £57.98. It would be impossible for an MSP to justify such a charge on any other form of taxation. We can only try to say that people are paying for the mistakes of a previous generation, but that explanation does not really wash.

You are making big political decisions that should be taken in the interest of the customer. As an individual commissioner, are you capable of making those decisions? What checks and balances are there in your decision-making processes? Have you examined the work of comparable authorities for other utilities? If so, are there things to learn?

Alan Sutherland: Absolutely. There are always things to learn from the experience of other utilities, other regulators and the like. The situation in respect of bills is that customers have to pay for the cost of being connected to the water and sewerage system. Regardless of whether huge amounts of water are drawn through the pipe, the fact is that the pipe will gradually decay and will have to be replaced, because the capacity has to be available to supply the service on demand, 24/7. Customers have to pay for that. I recognise

that there have been unpleasant surprises for many small business customers, but nearly 30 per cent of non-domestic customers have seen their bills fall in the past year. It is also important to recognise that a small business whose usage characteristics are exactly the same as those of a household pays less than all band G and band H households in Scotland.

11:30

The Convener: Before we move on from this subject, I would like to ask a technical question. The report that was produced by Dr John Sawkins for the water customer consultation panels talks about a consultation on a framework for charging. Is it feasible to have a proper consultation on a framework for charging in the run-up to the quality and standards III process?

Alan Sutherland: As I have said, that is part of our plan and we absolutely think that it should be happening. Again, though, there has to be a proper link between who pays what and who places what burden on the system.

Mr Brocklebank: Apart from the criticism of the spiralling costs, another major area of criticism that we have been told about relates to the apparent lack of clarity in the roles of the key industry players. The Federation of Small Businesses in Scotland claims that there is a need for clarity with regard to those roles and that there are potential areas of conflict between the water industry commissioner, Scottish Water, the water customer consultation panels and so on. For example, in its submission to the committee, the FSB says:

"The Water Industry Commissioner is responsible for representing the interests of the consumer, yet as the economic regulator his actions may run contrary to the interests of the consumer."

Do you agree that there are such areas of conflict?

Alan Sutherland: The FSB was kind enough to send us a copy of its submission—it is one of the few that I have seen. However, I am not sure that I agree with that statement because what is in the customer's interests is that the costs that they have to deal with are as low as they can be and, in providing advice to ministers, I am governed by the need to keep the costs as low as is genuinely sustainable. That is what the review set out to do and I believe that that is what it did. In that sense, on the assumption that customers want a level of service that is defined by investment, my technical role is to calculate the minimum level of money that has to be taken from customers as a group.

Mr Brocklebank: What about the further allegation from the FSB that tension exists between Scottish Water and the water industry commissioner and that that was unhelpful when

attempting to elicit the reasons for this year's prices and the likelihood of any change in the future? The FSB seemed to identify an element of buck-passing between the two.

Alan Sutherland: I am not aware of any buck-passing. In a situation in which one organisation is responsible for setting efficiency targets that another organisation has to meet, if there were not a healthy degree of tension between us, I suspect that we would be accused of being in collusion. There has to be an appropriate degree of tension if Scottish Water is to be appropriately challenged. None of us likes it when we are challenged by someone.

Dr Murray: As the regulator of the industry, did you express a view on the balance between standing and volumetric charges, which is obviously the principal source of some of the problems for small businesses?

Alan Sutherland: In the advice, we said that we believed that charges should be more cost-reflective—I think that we used the words “broadly cost-reflective”. Given that a significant cost is incurred in providing a connection, we argued that that needed to be reflected in higher standing charges than existed in two of the three authorities prior to the review.

Dr Murray: The phrase “phasing in increases”, which you used earlier, will cause terrible alarm in the small-business sector. There are small businesses in my constituency that do not make much money at all, and which perhaps have only a kettle and a toilet but which are seeing increases of 300, 400 or even 500 per cent. That also applies to the voluntary sector, churches and community groups that no longer get relief on water rates and which also saw enormous hikes this year.

I understand your point about domestic properties in bands G and H, but some small businesses are not making large sums of money and there is no way out for them. They cannot say, “I’m going to get rid of the water supply and the kettle and the toilet, so I don’t have to pay these charges any more.”

Alan Sutherland: I can give you another statistic that puts the situation in perspective. Nine per cent of households in Fife spend more than 5 per cent of their disposable income on water and sewerage charges. There is an affordability issue for small businesses and I acknowledge that some of the increases have come as an unpleasant surprise. Some small businesses receive a connection that costs substantially more than their total bill—in some cases total bills are less than Scottish Water’s billing cost, let alone the cost of providing the service. If we are going to have such a situation, other customers, including pensioners

and people on income support, are going to pay for it. We have to get to a situation where each group of customers is paying a charge that is broadly reflective of the costs that it places on the system.

Dr Murray: When rates are reviewed there is a period of transitional relief—in the case of my office there was transitional overcharging because the rates had fallen. You also said that 30 per cent of customers were now paying less than they did before. Did you consider whether it would be appropriate to have some sort of transitional scheme whereby the increases did not hit all at once and were phased in over a period of two or three years?

Alan Sutherland: Our analysis showed that more customers were going to be affected, because of the huge disparity in the types of tariff regime for businesses that each of the three authorities had. Our analysis showed that more customers were going to be affected by the transition of a phased move to harmonised charges. That is why we were content to see the harmonisation take place more quickly.

Jim Mather: I am keen to go back to ensure that I have a clear understanding of this. You are telling us that borrowing constraint is not an issue and that your lower borrowing limit is not an issue. I am keen for you to readdress that and take us through it because I do not think that many of the business people listening to you would understand that. We are also saying that there is a double counting of depreciation in adding the RAB and capital controls together. Surely that has an impact, as do your plans to start repaying debt from 2005-06.

Alan Sutherland: I quash your last statement as it is a misinterpretation of the financial model presentation in the review. Clearly, no revenue caps have been assumed beyond 2005-06 and all we have done in the model is show the existing figures being indexed up for inflation. Clearly, there is no intention on our part that there should be substantial repayment of debt after 2005-06. Indeed, the plan would be for the interest coverage ratio to stay at or around 1, depending on the phasing of the investment programme. There is no intention to repay debt after 2005-06.

Ms Alexander: I have two questions. First, I want to return to a point that has arisen in your evidence. You seem to suggest that if you received from ministers either financial information or directions that you came to believe were inaccurate, it would not be proper for you to comment on that information. Is that a fair reflection of your view?

Alan Sutherland: I am told what the public expenditure is and how that figure is to be

calculated if there is to be consistency across the Scottish public sector and, I assume, across the UK public sector. I calculated the numbers exactly in line with the advice that I was given by Treasury and Scottish Executive officials.

Ms Alexander: I am asking a slightly different question. If you were in receipt of either information or a direction that you came to believe was erroneous or inaccurate in some way—albeit inadvertently so—would you voice your concerns if that information or direction came from ministers?

Alan Sutherland: Yes.

Ms Alexander: Can we take it that you had no such concerns about the financial information that you were given in the letter that you received this year?

Alan Sutherland: Any concerns that we had or requests for clarification that we made, with regard to the letter, were examined in detail and we were reassured in full that there were no grounds for those concerns.

Ms Alexander: Would there ever be circumstances in which it would be appropriate—in this age of freedom of information—to share those concerns more widely?

Alan Sutherland: I am sure that it would always be useful to go through the details of process, but many of the questions that are asked are of a very technical nature. It is important that the asking of questions is not limited by the selective use that could be made of that information later.

Ms Alexander: Can we take it that if you had any concerns about the accuracy of the information that was made available to you, you would be confident that they would be addressed and that, if they were not addressed, you would be willing to pursue the matter further or would have done so?

Alan Sutherland: Absolutely.

Ms Alexander: Secondly, I have a much more general question. Clearly, you are the nation's expert on water industry structure. Do you believe that the current monopolistic structure of Scottish Water is the optimal way to deliver the efficiencies that are doubtless required in the short and medium term?

Alan Sutherland: I suggest not only that I do not necessarily know the answer to that, but that no one does. The industry in England and Wales has already achieved efficiencies significantly in excess of what Scottish Water is being asked to achieve. As a consequence, customers in Scotland are paying more. We are attempting to ensure that bills for Scottish customers are brought to much better levels of value for money than they are currently at. I am not sure whether it

would be in the customers' interest for there to be yet another major overhaul of the structure of the water industry in Scotland.

Would other pressures be effective in helping to bring about efficiency? From what I have seen of the Executive's proposals that are out to consultation on the new bill, competition within the retail segment that will not in any way impact on public health or the environment is likely to introduce some additional pressures that can only help Scottish Water to achieve its efficiency targets. Again, that is a fairly limited move and I am not convinced that wholesale restructuring at this stage would be desirable.

11:45

Ms Alexander: If I accept that we cannot look forwards, we can at least look backwards. Within the public ownership framework that the Executive decided on, did the reorganisation and the establishment of a single monopolistic water company in Scotland prove to be the best way of delivering value for money? Would a more diverse structure have delivered gains more quickly?

Alan Sutherland: The best summary of that is in two points. First, in its first year, Scottish Water delivered a 10 per cent real-terms improvement in efficiency levels. That is the first time since 1996 that the industry in Scotland has become more efficient and that is a big credit to the new management. Secondly, Scottish Water made significant progress by building a team of managers who were capable of making such a start and I am sure that they will achieve the targets that have been set or, if they do not, they will get very close to achieving them.

Jeremy Purvis: You have a statutory duty to have regard to the recommendation of the water customer consultation panels. What happens when a report such as the one on the principles of charging for water and waste water, which recommends revising the charging structure and rebalancing charging—the debate that Elaine Murray and I touched on earlier—arrives on your desk?

Alan Sutherland: It is read and it is taken into account.

Jeremy Purvis: Then put into a filing cabinet to gather dust.

Alan Sutherland: No, absolutely not. We have already talked about the processes that we will go through in the next couple of years to determine what the advice to ministers ought to be for the next period for which they will seek advice.

John Swinburne (Central Scotland) (SSCUP): What has come across this morning is the totally unacceptable complacency displayed by Scottish

Water, particularly when so many small businesses are suffering due to overcharging. Should there be a complaints procedure that has more teeth so that Scottish Water can be more accountable and give better consideration to small businesses that are being hammered by your organisation?

The Convener: Scottish Water is not Mr Sutherland's organisation, to be fair.

Alan Sutherland: I have genuine sympathy for the small businesses that have had to face extensive increases. However, either they will have to pay a charge that more broadly reflects the service with which they are being provided, or I will have to increase domestic charges and increase the proportion of households in Fife that are paying more than 5 per cent of their income in water charges. If that is the pattern in Fife—given that Fife is fairly typical of Scotland as a whole—many people will be in the same situation. For example, if someone is on a minimum income guarantee and is in a band A household, a water bill of the order of £5 or £6 a week—which is the lowest that they could be facing for water and sewerage—means that they are, by definition, paying 5 or 6 per cent of their income in water and sewerage charges.

John Swinburne: The only thing that you did not mention was the profit motive. Is there no chance of bringing the profits down marginally to alleviate bills for small business users, for example?

Alan Sutherland: One of the beauties of having Scottish Water within the public sector is that all the profit is reinvested for customers.

John Swinburne: Allegedly.

The Convener: We also have witnesses from Scottish Water, so we must move on, but I will take three more members.

Fergus Ewing: In response to Wendy Alexander's questioning earlier, you said that you would voice concerns, presumably to the Scottish Executive, about any aspect of the letters and instructions that you receive from it regarding your financing. I think you will agree that the commissioning letter is key to setting the parameters within which you must operate. That letter contained a serious error, because it massively underestimated the amount of borrowing that you could have had, and thereby the chance to give customers a better deal. Did you voice any concerns about that commissioning letter of 21 August 2001 to the ministers and, if so, what were those concerns?

Alan Sutherland: I asked ministers what they meant by a risk analysis and how they would like to see that presented.

Fergus Ewing: Did you voice concern about the mistake that was identified in the analysis of Jim and Margaret Cuthbert, which I described earlier?

Alan Sutherland: No.

Fergus Ewing: Do you accept that it is a concern?

Alan Sutherland: I am obviously aware of the press comment about the Cuthberts' paper, but I cannot comment on the detail of it.

Fergus Ewing: The penultimate paragraph of the letter from Mr Finnie to you states:

"As you are aware, the public expenditure figures are absolute limits, and not targets."

Do you accept the Cuthberts' analysis that that statement, too, is wrong, in that following the introductory period of resource accounting and budgeting, the use of the phrase "absolute limits" is technically incorrect?

Alan Sutherland: Once again, my source for the information is the press comment, and it would be rather remiss of me to make judgments based on press comment about what evidence to you says.

Fergus Ewing: No, I am just asking about that phrase in the letter. I am not asking about any press comment. Mr Finnie stated that the public expenditure figures were absolute limits. It has been put to me that that is incorrect because, during an introductory period of RAB, allowance is made for depreciation. Therefore, did you voice concerns about error number 2?

Alan Sutherland: I was led to believe that in the process of introducing RAB, public expenditure would contain absolute limits, in just the way that the old external funding limits system had worked.

Fergus Ewing: I am sorry, but that is not the answer to the question.

Mr Brocklebank: I have a further question, but briefly on that issue, have you actually read the Cuthbert paper, and if not, why not?

Alan Sutherland: It has not been given to me.

Mr Brocklebank: But presumably it is in the public domain.

Members: No.

Mr Brocklebank: I have certainly seen it, so I am surprised that Alan Sutherland has not.

Finally, I want to pick up on something that Wendy Alexander asked you about. If it became apparent to you in your role as the water commissioner that the public could get a better and cheaper water service if it was taken outwith the public sector, would you believe that that should happen? Do you believe that the water

industry should remain in the public sector for ideological reasons, even if it can be proved that we could have a better service otherwise?

Alan Sutherland: In my first ever lecture in economics, my economics lecturer said to me, "If you want to be an economist, you must forget everything you ever said or thought about politics." I have tried to live my life exactly according to that principle. I have no political views. I do not get involved in discussions about ideology. I believe in the dismal science.

Mr Brocklebank: But as a watchdog, do you not have a responsibility to give your view?

Alan Sutherland: I would give a view, in a completely unbiased way, of whatever was going to be in the best interests of the customers of the water industry in Scotland.

The Convener: In other words, political decisions are for politicians, and economic advice is for the water industry commissioner.

Alan Sutherland: It would be absolutely inappropriate of me to do anything other than get the best deal possible for customers.

Mr Brocklebank: Even if you thought that the whole system was a disaster.

Alan Sutherland: If I thought that the whole system was a disaster and was incapable of delivering the benefits that the customers of Scotland deserved, I would be stating that clearly. However, as I say, the evidence is that, in its first year, Scottish Water has improved its performance by 10 per cent in real terms.

Dr Murray: You have expressed concern about the fact that people in Fife and in other areas might have to pay more than 5 per cent of their income on water charges but, from the way in which you have described it, the charging regime seems to be based on the provision of the service, not on ability to pay. Is there not a slight discrepancy there? Will you be advising ministers to extend the water rates relief scheme for people on low incomes?

Alan Sutherland: I am not sure that that scheme targets the affordability of charges. It was designed to transition people, particularly those in the north, who had seen very large increases in their bill. I say that because the scheme has never provided any help—except in the first year—to band A households, which represent a quarter of all households in Scotland. One assumes that some of those households include people who are on minimum income guarantee or on the minimum pension.

Dr Murray: If we use a comparison with council tax, for example, people on low incomes can get some sort of council tax relief. Would you advise

ministers to bring in a similar system of relief on water rate charges?

Alan Sutherland: Ministers have never asked me for advice on affordability issues. If I were to be asked for such advice, I would say that customers can pay only what they can afford. Most customers try to pay their bills, if they can, but if the burden of doing so gets too high, they default and become non-payers. That non-payment has the effect of increasing other customers' bills. The current system provides some degree of protection to more vulnerable households, but it is clearly not as progressive as the council tax system itself, because there are no reliefs in the way in which there are for council tax bills.

The Convener: I have a final question. You made great play of the fact that you are a practitioner of the dismal science of economics. It is clear that developers, local authorities and others are concerned that the pattern of development of water and—especially—sewerage services is not closely enough geared to making the most of economic opportunities; in fact, the provision of services could even be a barrier to development in some areas. Have you been encouraged to take into account such growth and development issues when you consider the pattern of investment or is the pattern of investment dictated entirely by service provision and service quality issues? As an economist, do you believe that that makes any rational sense?

Alan Sutherland: There are two points. First, about 4 to 5 per cent of the current investment programme is targeted at first-time provision of sewerage or water connections, so there is money—albeit a limited amount—available for addressing development constraints within the programme. Following the consultation, Scottish ministers added some extra money, although that is not as much as many people would like.

The issue arises where the revenue stream to Scottish Water from providing a connection is less—in present value terms—than the costs that are incurred by connecting that new person to the system because, if that is the case, other customers, including the less well off and the charities that do not have relief, end up paying the excess costs. The question of development constraints is properly a matter for ministers within a much broader strategy for housing or economic development in Scotland. It would be inappropriate for me to make decisions or purport to give advice on something on which I am not an expert.

12:00

The Convener: However, nothing in the instructions, advice or letters that have come to

you demonstrates that the issues are being taken into account.

Alan Sutherland: Except to the extent that, within the quality and standards process, money was made available for the easing of development constraints. Money was made available in addition to the middle option, which is what ministers ended up confirming in the quality and standards process.

The Convener: I thank you and your colleagues for giving evidence this morning. As you know, we will now take evidence from witnesses from Scottish Water, so you may wish to stay to listen to them, as they have listened to you.

Our representatives from Scottish Water are Professor Alan Alexander, chair; Dr Jon Hargreaves, chief executive; and Douglas Millican, director of finance. The committee has received a statement from Alan Alexander, which we have had the chance to read. If you want to add anything to that, Professor Alexander, I am happy for you to do so now.

Professor Alan Alexander (Scottish Water): I will summarise the statement. We need to make clear our views and where we stand in relation to four major issues in the broad range that the committee is examining. First, as I say in the statement, we think that we are a very accountable body in a continuing sense—we are accountable both to our owner, the Scottish Executive, and to the Scottish Parliament through committees such as the Finance Committee and other parliamentary procedures. To add colour to that, I can tell you that this is either the fourth or fifth time—I have lost count—that I have given evidence since Scottish Water was mooted and the third time that I have given evidence since it was created. Our accounts are audited by external auditors appointed by the Auditor General for Scotland. The Auditor General then reports to Parliament, which produces a further line of accountability through the Audit Committee.

The second point is Scottish Water's financial position. It is important to emphasise that Scottish Water has only two sources of finance, both of which are tightly controlled. One is revenue from customer charges, which has to be within the revenue cap agreed by ministers on the advice of the commissioner. The second is borrowing determined by Scottish ministers. The cost of servicing that borrowing has to come from customer charges. It is important to emphasise the fact that the targets are set for us by Scottish ministers and they form the basis on which we develop our strategic business plan, which in itself is another medium of accountability.

The third point relates to regulation, which is a central concern for the committee. For the

moment, Scottish Water is a monopoly supplier of water and waste-water services, except to trade customers that deal with their own effluent. I make it clear on behalf of Scottish Water that we believe that it is entirely proper that a monopoly business should be robustly regulated—we have no problem with that. We are regulated on water quality by the drinking water quality regulator, on environmental matters by the Scottish Environment Protection Agency and on economic and customer service matters by the water industry commissioner for Scotland. I note that the water customer consultation panels have been mentioned this morning. We are scrutinised—although not formally regulated, which is important—by the WCCPs.

The key part of the regulatory framework in which the committee has an interest is economic regulation. We accept unreservedly that it is right that the WIC should advise ministers on the economic basis on which we operate, our customer service standards and the efficiency of our performance. We co-operate fully with the process by which our scheme of charges is determined.

Within the revenue cap that is established in the commissioner's strategic review, we submit to the commissioner on an annual basis our scheme of charges. If we can agree with the commissioner, as we have hitherto, the scheme is communicated to our customers. In the event that there is a disagreement and we cannot agree with the commissioner, the charges scheme is determined by the minister. I emphasise that point because the process that I have outlined seems to be a clear example both of effective regulation and of clear accountability. In that process, everyone knows who has what duty. The process also illustrates the context in which the board of Scottish Water makes its decisions on charges.

It is important to point out that, beyond the formal regulatory process, we are subject to scrutiny by the WCCPs. Their responsibility is to examine the continuing interface between Scottish Water and its customers, rather than to regulate that relationship.

My final point relates to performance. We have been in operation since April 2002. The situation with which we are dealing was created in large measure by decisions that were taken before then. In August, we laid the report and accounts for our first year before Parliament. Last week, we laid the interim results for our second year before Parliament. Our performance is firmly in the public domain.

I am talking about performance against the targets that ministers have set for us. The board of Scottish Water is strongly of the belief that its responsibility for the governance of Scottish Water

obliges it to ensure that its published accounts give a true and accurate statement of its performance, as certified by its external auditors. As the commissioner indicated in his evidence, the accounts demonstrate that in our first year we have made considerable progress towards meeting our targets.

We have also begun to deliver our capital programme. The vehicle that we have designed to do that will enable us to meet the exacting capital expenditure targets that have been set for us in a way that traditional procurement methods would not.

Details of most of the points that I have made are contained in the paper that I circulated to members before the meeting. My colleagues and I are happy to respond to questions on any of those matters and, I would guess, on any other matters that members may wish to raise.

The Convener: I will go to the reporters first.

Jeremy Purvis: I have some structured questions on accountability, which are similar to those that I asked earlier. You say in your submission that the ways in which you are held accountable are effective. Is there scope for more public lines of accountability to be fitted in? Much of the evidence that we have received deals with what is laid out in statute with regard to your roles and responsibilities. However, the interaction between the Executive, the water industry commissioner and Scottish Water is often unclear, especially when it comes to intervention and the making of political decisions, such as those that Elaine Murray discussed. There is no public document that stresses that interaction. Is there scope for one?

Professor Alexander: I think that we have to make a distinction and define public accountability in the sense of the accountability of Scottish Water to its owner, the Scottish Executive. My belief is that that form of accountability is pretty clear. We have published targets and revenue limits, which we may not exceed. We have a statutory obligation to publish not only an annual report but—perhaps uniquely for a public body—interim reports. Every six months, a public statement is made of how well our auditors say we are doing. Inside Scottish Water, that feels accountable. That is one kind of accountability.

There is also the question of a more general accountability to the public and to our customers. We do a large amount of direct consultation with customers and their representative bodies. We consult on customer standards and we consult local communities on what we are doing. From where we sit, our organisation looks and feels very accountable. That is not to say that we would not accept that there are always ways in which we

could improve both accountability and communication. However, I do not feel that there is an accountability deficit of the kind that you suggest.

Jeremy Purvis: Do you have a consultation code?

Professor Alexander: We have a consultation code in draft form. It is with the WCCPs at the moment for their comments. Once the board has received and considered their comments, the consultation code, which will be fairly detailed, will be published.

Dr Jon Hargreaves (Scottish Water): We are now going over the second iteration of the code with the WCCPs. We hope to have it completed and signed off by all parties, including the water industry commissioner, shortly after Christmas.

Jeremy Purvis: And that will be a public document.

Dr Hargreaves: Absolutely.

Jeremy Purvis: Some of our evidence relates to the time frame for making decisions for reviews, particularly those that concern charging and operations. What observations do you have regarding the suggestions that we have received that the notice for a review is often late?

Professor Alexander: What kind of review are you referring to?

Jeremy Purvis: A strategic review. I will give you an example of something that Ofwat is doing. Its latest full strategic review started last year and the decisions arising from that are to be implemented in 2005—it is early beginnings now. That does not seem to reflect the practice in Scotland.

Professor Alexander: The timetable is one that we follow, rather than create. The earlier we know the circumstances in which we are to operate over the forthcoming period, the better.

Two key, closely related issues will govern how Scottish Water works over the next regulatory period. One is the water industry commissioner's next strategic review of charges. The other is the quality and standards III process, which is currently under way. The process will be a difficult one, but out of it will emerge an investment profile for Scottish Water for the next regulatory period. The review and the Q and S process must be conducted in parallel. My response is that the sooner we have clarity, the better we will be able to operate—consistent with the widest possible discussion as to what the various documents should contain.

Dr Hargreaves: About four or five months ago, we submitted a short paper to the Scottish Executive, outlining the elements that we felt were

important in the whole process—I do not think that those were present in Q and S II, to be honest. The commissioner said publicly many months ago that he favoured a consultation on charges.

I believe that, this time, the Q and S process needs to be much more detailed and explicit about what it will not do. I am thinking of development constraints, for example. One of the options last time included a large chunk of money in relation to development constraints. That high-cost option was rejected by ministers for the good reason of keeping charges down. However, it was not obvious enough to the wider public of Scotland what would be omitted by accepting a lower Q and S II package. This time, we will have to be much more explicit about what is in and what is out.

Despite the fact that England and Wales have adopted some of our processes, the whole process of Q and S III is much better in Scotland—it is much more open and more stakeholders are involved. The outcome will be widely consulted on and, I hope, discussed through engagement rather than through just sticking out a document and hoping that people respond to it.

Scottish Water believes that, through whatever channels we can manage—not just our own, but the water industry commissioner, the WCCPs, the Scottish Executive and so on—a proper debate on tariffs and on what is in and out of the investment is required. If we do not get that debate, we could spend the next four, five, six or seven years explaining why something is not being done instead of concentrating on the things that are being done.

12:15

Jeremy Purvis: I have another question on investment. In my area, which is the Borders, I am pushing Scottish Water by asking basic questions, along the lines that the convener mentioned, about holding back development because of lack of investment. I have asked whether Scottish Water can put a figure on the amount of investment that is necessary. That would be a first step. I acknowledge that you do not know how much money you will have to invest, but Scottish Water cannot tell me how much money it wants to invest in the Borders.

Dr Hargreaves: We can be much clearer about that now than we could have been several months ago. One of the benefits of the current structure of Scottish Water, as opposed to when there were three separate water authorities, is that we are able to take a national view of these things. We have spent the past 12 months in detailed discussions with all the councils, the House Builders Federation and so forth. The process was very open and all the developments, whether

desired or urgent and imminent, were discussed. We now have a long list, which is with the Scottish Executive. If the costs on the list are added up, it comes to many hundreds of millions of pounds.

As the commissioner mentioned, in the current Q and S II period, Scottish Water has some money to deal with rural development constraints and a small amount in its programme to deal with development constraints more generally. In addition, we are spending some £200 million on improving compliance at sewage works and on upgrading some of the sewers. A secondary benefit of that work is that it will relieve development constraints; we are now back talking to councils, including the council in Mr Purvis's area, about what can be relieved. Sitting here right now, I have to say that the sum involved will not come anywhere close to resolving the issues that all of us round the table know exist out there. That is why the matter is with ministers at the moment. It is not something that we can resolve.

We are being honest and open and we are involving people. We are taking those detailed discussions right down to the level of whether, if we cannot let 10 houses, we can let five. That is the level of detail.

Jim Mather: The specific concerns raised by Jim and Margaret Cuthbert have been substantiated and crystallised today. I am interested in your view of the issue over time. Did you at any point challenge the borrowing limits that were passed to you by the water industry commissioner? Were you aware of the issues of double counting and depreciation that have impinged on the borrowing position?

Professor Alexander: I would like to be as helpful as possible, but I have to say that I do not think that that issue involves Scottish Water. If it is an issue—and I have no certainty that it is—it is one between ministers and the commissioner. As I said in my opening statement, we are given the parameters within which we work—we were given parameters about borrowing and about the revenue cap. Beyond that, it would not be proper for me to go.

Jim Mather: Are you saying that there is not much that you can do beyond pressing for efficiency to press down the water charges that are faced by water charge payers?

Professor Alexander: We are constrained by the targets that we are set and by our sources of finance. We are bearing down as heavily as we can; we are putting a lot of pressure on the business to squeeze out inefficiencies. However, we have to do that within the parameters that our owner gives to us.

Douglas Millican (Scottish Water): There is an issue about the medium to long-term sustainability

of the industry. There is no question but that one could, at least theoretically, keep water charges depressed in the short term, as happened to a large extent in the late 1990s. All that that would do, however, would be to store up a problem for future generations.

If one looks at the financial position under which we operate in the review period and the targets that we have agreed with the Executive, one sees that about two thirds of our investment is being financed out of revenue and about one third is being financed out of debt. We could have a long debate about whether that is precisely the right split, but it falls within the parameters of reasonableness, because it represents an attempt to ensure that we have the business and industry on a financially sustainable footing for the medium to long term.

Jim Mather: It is interesting that you talked about the two thirds-one third split, which I think is penal. The previous generation of users is totally off the hook thanks to the grim reaper and we are buffering future generations by wearing an incredible hair shirt, which looks to be a function of the additional rigour of the limitation on debt imposed by the water industry commissioner and exacerbated by double counting and depreciation. Which elements of the water industry commissioner's responses today were news to you? Were the double counting and depreciation news to you?

Douglas Millican: I am not sure how significant depreciation is, because we are dealing with cash. We are dealing with the impact of access to borrowing to finance investment and the impact of revenue as it hits customers through charges. Depreciation is an accounting calculation to estimate the using-up of assets over time. We derived our plans to meet the targets that were set by the Executive by looking at the cash impact in terms of our access to borrowing and the resultant impact on charges to customers.

Jim Mather: The depreciation has had an impact on borrowing, however—the excessive calculation of depreciation has, in effect, reduced the amount of money available to you for borrowing, which has cash implications.

The Convener: Before Douglas Millican answers, I should point out that, although Jim Mather keeps saying that there is double counting and depreciation, I am not sure that there is.

Jim Mather: I will be interested to look at the *Official Report*, which will substantiate what has been said.

The Convener: I just want clarification from Douglas Millican about whether he shares Jim Mather's view.

Douglas Millican: When the strategic review was set up, the industry was operating under a different RAB regime. The way in which the public expenditure control total was set took account of both capital expenditure and profit before interest and tax. By definition, that public expenditure control total includes both current expenditure and the depreciation on assets. That is the function of the way in which the calculation worked. I return to the point that, to an extent, the finances for the industry have to be looked at on a cash basis. On that basis, the arrangements, the targets and the access to borrowing that we have fall within the parameters of reasonableness.

Jim Mather: I understand exactly what you say, but the approach seems remarkably unsophisticated. We have been in a protracted period during which there has been grotesque underinvestment in the below-ground assets of the pipes. We are now hoist on a petard. Although we might be spending large sums of money, the fact that there has not been a mature approach to replacement in the past impinges on your ability to move forward.

Douglas Millican: Undoubtedly, when one has to reckon with past deficiencies, there are options. One option is to follow the approach that is being taken; another option would have been to continue to defer problems much further into the future. If we had followed the latter option—and the Executive had made the funding available—we could certainly have funded more of the current investment programme out of debt. However, that would only have increased the level of debt that Scottish Water was carrying; it would have meant that a greater percentage of future customers' bills would go on interest and debt repayment. That would ultimately result in charges in the latter half of this decade or in the next decade being higher than they would be under the approach that we have taken.

Jim Mather: Have you done any scenario planning with various levels of debt? Are there models that show what the implications would be or are we dealing only with supposition?

Douglas Millican: A number of sensitivities can be worked out. The advantage of the current arrangements is that, as we move into the next regulatory review period, we will have a financially sustainable industry that, if charges stay at broadly the level that they will be at the end of the review period, will probably be able to finance an investment of at least £450 million a year out of the operating cash flow coming from Scottish Water. Undoubtedly, that will give the Executive options in the next review period: the Executive can either keep charges at their current level or lower charges by having a lower level of investment or by increasing borrowing. I believe

that, at the moment, we are putting the Scottish water industry on a fairly secure financial footing for the longer term.

Jim Mather: Economic growth is our top priority, yet the economic growth of many small companies is being impinged on by the charges that are being imposed on them. Can you think of any companies in the private sector that would try to fund two thirds of their capital programme out of revenue?

Douglas Millican: You need to consider the nature of our capital investment programme. It contains two key elements: one is to do with replacement and one is to do with enhancement. The water industry has been around for hundreds of years and much of the work that we are doing is to replace aging infrastructure. Although it might make sense in the short term for a business to finance the replacement of assets and infrastructure by increasing the debt significantly, that would not do in the medium term. However, where we are growing the asset base by connecting new customers to the system or providing additional levels of service such as higher-quality sewage treatment, it makes sense to finance that growth or enhancement out of debt.

Jim Mather: When the infrastructure has been allowed to deteriorate severely, surely replacing it is adding to the asset value. Surely there is a sins-of-the-fathers element to the situation.

Douglas Millican: If you follow that argument through, you could argue that that backlog of investment should be financed out of debt. Although I would not support that point of view, it is plausible. If that decision were taken, there would need to be a recognition that the next generation of consumers would be paying the interest and debt repayment costs of that programme every year.

Ms Wendy Alexander: Like Professor Alexander, I feel that the committee has been struggling all morning with the financing of the industry. There are two possible scenarios: one, which we have explored thoroughly, is that the borrowing limits that have been set represent proper discretionary prudence for the financing of the industry; the other scenario, which Professor Alexander suggested—I agree with him—is that there might be a possible accounting error arising from the complex transition to RAB. That allegation has been made, but it has not been resolved. Given the level of charges this year, it is not surprising that this is a matter of public interest and concern. We all have an interest in resolving the matter, but it is—inevitably—an issue on which only the experts can comment.

I have three questions. First, were you aware of the controversy in the press about the issue? Secondly, have you or any of your officials sought to obtain a copy of the Cuthbert report to read it?

Professor Alexander: Was that—

Ms Wendy Alexander: Are you aware of the controversy and have any of your Executive officials—

Professor Alexander: I was waiting for the third question. I am sorry.

Ms Wendy Alexander: That is fair enough. Let us deal with the first two, first. Were you aware of the press controversy?

12:30

Professor Alexander: Yes, we were aware of the press controversy. I saw the story in one of the Sunday newspapers when first it hit the public press. I came into the office the following morning and asked whether we had a copy of the Cuthbert report. I was told that we had a copy and that my colleagues had examined it.

I must emphasise the fact that we are essentially the operating and delivery part of the Scottish Water service. We have been operating on the basis of the figures that were set for us, which were—as the earlier discussion demonstrated—a combination of what could legitimately be financed from charges and, because of the risk that was inherent in the changing of the business, what could be financed by borrowing.

Ms Wendy Alexander: I accept absolutely the fact that you are the operating arm and, given how close you were to the industry, I am not surprised that you thought that the prudent approach was to obtain a copy of the report and to read it, after you saw the controversy in the newspaper. Were you therefore surprised by the water commissioner's testimony that he had neither seen nor read the paper?

Professor Alexander: I am not going to comment on that.

Ms Wendy Alexander: I did not expect you to.

Professor Alexander: It would not be proper for me to do so. I appeal to you on that, convener.

Ms Wendy Alexander: Given the accountability structures that exist between ministers and the various roles and responsibilities in the water industry, whose role is it to allay public anxiety about whether there has been an accountancy error? I accept that it is not your role.

Professor Alexander: I will answer that by referring to what I said in response to Mr Mather's earlier question. There are, generally speaking, three players in the business—us, the commissioner and the Scottish Executive—and on that particular issue we were a recipient rather than a participant. I hope that I will not be thought to be ducking Ms Alexander's question when I say

that I do not believe that Scottish Water should provide such clarification.

Ms Wendy Alexander: Would you like to hazard a guess as to whether that is a matter for ministers or for the commissioner?

Professor Alexander: You are pressing me hard and I am trying hard not to be pressed. The first thing that would have to be established—by someone other than us—is whether there is, *prima facie*, a case to answer. If that is established, I would have thought that both parties to the interchange to which Mr Ewing referred earlier would have something to say about it. However, I do not think that we would.

Ms Wendy Alexander: I could not agree more with the chairman of Scottish Water in that respect. If we are to build public confidence in his organisation and public awareness and acceptance of the sort of prudent financial ratios under which Scottish Water undoubtedly needs to operate in the future, there cannot be a shadow of doubt about whether an accounting error has entered the process. It is unfortunate for Scottish Water that neither of the two parties has yet found a way to clear the matter up to the satisfaction of all of us and move us on to the fundamental operating environment for the company.

Professor Alexander: Our position on all matters regarding our operating framework is that we need clarity. It does not matter to us what clarification says as long as we know that it is clear.

The Convener: The committee will pursue clarity. Perhaps the most appropriate mechanism for that is to write to the Scottish Executive asking specific questions on the matter. I will certainly consult the two reporters on how we can take that forward.

Fergus Ewing: I am indebted to Wendy Alexander for ensuring that the political buck—which is so often in orbit—has landed firmly on the desk of the Minister for Finance and Public Services.

I want to ask about the infancy of Scottish Water and the water authorities. In the “Strategic Review of Charges 2002-06”, we are told that, when each of the water authorities was established, they were “cash negative”—that is the phrase that the WIC came up with—because they had inherited a total debt of £1 billion. I could use many phrases to describe its having debts of £1 billion, but “cash negative” would not be the first that came to mind. Perhaps I could refer to the poor house, or to Enron-scale debts.

Reading the tables that the WIC has provided for us, we discover that this year alone we are paying £152.9 million in interest charges. That

relates to debt that the WIC has described as £1.9 billion, so more than half of the total debt was inherited first by the water authorities and then by Scottish Water. That means that more than half of the per-annum debt charges relate to inherited debt. I have calculated that if the inherited debt is removed, the total is equivalent to £100 for each of the 2.26 million domestic water charge payers in Scotland over the next three years.

You have said that the income that is available to Scottish Water as a non-departmental public body—or, as it is known to the world, *quango*—is the revenue that you make. In raising this point, I express the concern of Bill Anderson, the campaigns manager for the Forum of Private Business, whose paper pointed out that the major part of the inherited debts is from the old water boards and that those debts were written off in England and Wales during privatisation in 1989. Has there not been an injustice in the Government’s treatment of water charge payers north of the border? Mrs Thatcher gave a green dowry for privatisation and the selling-off of water south of the border, but Scotland has Enron-scale debts of £2 billion, half of which were acquired before you could get your sea legs.

Professor Alexander: I will make two brief points before I hand over to Douglas Millican to deal with some of Fergus Ewing’s calculations. First, to describe the debts as Enron-scale suggests that there is something illegitimate about them. There is nothing illegitimate about them; they are part of Scottish Water’s inheritance.

Secondly, Scottish Water is not technically a non-departmental public body. We do not get anything other than borrowing consent. We do not get any subvention in the form of grant in aid. We are technically a public corporation. It is worth pointing that out.

Douglas Millican: The question is straightforward but the answer is complex and it goes to the heart of many of the issues concerning the water industries in Scotland and south of the border. It is difficult to do direct spot comparisons between the situation in Scotland and that south of the border, whether we are considering our efficiency position or our debt, because the historical positions are very different.

In England and Wales, the industry was privatised in 1989. As part of the privatisation arrangements, different financial provisions were made for each of the companies to ensure that they could be floated successfully. I understand that the level of that debt write-off or cash injection varied significantly from one company to another so that any average that there might be in England is a purely arithmetic average of a wide spread across the companies in England.

In Scotland, before the water authorities were created, there was a significant level of debt commutation in 1996. Some people have done a lot of work to discover the relative scale of that debt commutation, compared to the write-offs in England and Wales in 1989. I would rather leave it to those people to comment on the detail of the fairness of the Scottish settlement relative to the English one.

I have two more points to make. First, it is ultimately a political decision, but if the Executive decided that it wanted to write off debt, there is no free money. Any debt that is written off will move from being a burden on consumers to being a burden on taxpayers.

Secondly—I come back to our role as an operator—the cost of our debt amounts to 15 per cent of our revenue. Although it is difficult to do direct comparisons with English and Welsh water companies because of their different financial structures that have a mixture of debt and equity, paying 15 per cent of customer revenue in debt service through interest is consistent with the broad levels of interest and equity-return burden that are borne by English companies today.

Fergus Ewing: I am grateful for that answer, which does not come as a crashing surprise. Can you share with us the calculations to which you refer, which compare the 1989 and the 1996 figures?

Dr Hargreaves: The Scottish Executive has published the fact that about £700 million was written off when the three water authorities were formed in 1996. The Executive is probably the best source for the information that Fergus Ewing seeks. The company for which I used to work in the north-east of England had all its debt written off because it was paying 40 per cent of its revenue in interest charges, having built Kielder dam and the Tyneside scheme. As Douglas Millican said, other companies in England and Wales were left with sizeable chunks of debt. That judgment was made on floatation, as much as anything.

The Convener: There is an issue of the speed with which you are reducing Scottish Water's debt. Are you comfortable with the framework for debt reduction and control that has been established by the water industry commissioner on the basis of his economic models?

Dr Hargreaves: Do you mean debt that is owed to us by customers?

The Convener: No, I mean your borrowings.

Douglas Millican: The profile of debt that we have agreed with the Scottish Executive over this regulatory period—which runs only to March 2006—shows our level of debt continuing to grow

throughout that period, because we fund part of our investment programme through debt. We do not anticipate making any reductions in our total level of debt before March 2006.

The Convener: I want to pick up an issue that Jim Mather raised with the water industry commissioner. The rate of repayment that you are being asked to achieve concentrates the burden very heavily on present customers. In your view, is that reasonable in the broadest economic circumstances? What do you see as being the particular benefits of that process, as opposed to a more extended process of debt repayment?

Douglas Millican: I need to be clear that I understand the question correctly. Are you referring to the amount of our investment that we are funding out of revenue, as opposed to debt, during this period?

The Convener: Yes, and to the terms on which you must repay debt.

Douglas Millican: The debt profile that we have agreed with the Scottish Executive differs from the assumptions that are set out in the strategic review of charges. We anticipate that our level of debt will grow from the £2.1 billion that we inherited in April 2002 to £2.7 billion in March 2006.

Dr Hargreaves: That question relates to what is written down in the commissioner's strategic review of charges. The commissioner answered that question by saying that the framework for debt reduction control was part of the economic model that is set out in the review, and that we will examine it again in 2006, when the next strategic review of charges will take place.

I will set out the view that Scottish Water takes at a very high level. Unless we stop spending money, we will have ever-mounting debt. As the commissioner said, for the next 10 years we will spend £300-plus million on the industry just to stand still—never mind to implement new directives that we know are in the wings and will push up expenditure. At issue is whether we will ever be able to repay debt.

We have discussed the matter with our board colleagues and believe that we must balance the economics of the business with what customers can afford. We should start the debate by asking what is a reasonably affordable price, bearing in mind the commissioner's point that customer groups should pay for the service that they receive. Any decision to do otherwise would be purely political. However, if there is to be cross-subsidy, it should be transparent and open so that everyone knows that it is happening.

In our view, before we embark on the next review period, which will apparently last eight

years, there must be public discussion of, and consultation on, the balance that is struck. At the end of the day, that balance will be determined by our number of customers, our revenue per customer and our investment. However, the total impact on customers will also need to be included in the equation—it has to be a key element in that decision-making process. If the decision to write off debt more quickly than it needs to be puts Scotland at a disadvantage compared with England and Wales—or, indeed, the rest of Europe—vis-à-vis investment, it would need careful consideration.

12:45

Professor Alexander: I should emphasise that the questions about the proper rate at which debt should be paid off and about the proper balance between capital from current revenue and capital from borrowing underline the need for a detailed and honest debate in bringing together the two processes of the commissioner's strategic review for the next period and Q and S III. Those things are so fundamental that we need to try to reach a consensus about the best way to proceed.

The Convener: I was trying to highlight the potential danger of getting lost in the middle of the two processes.

Professor Alexander: Yes, indeed. There is also the question that Douglas Millican alluded to earlier, which is about how payment should be made for capital to maintain the system and for capital to enhance the system. There are questions to be asked about whether those investments should be paid for similarly or differently.

The Convener: Time is moving on and three members still want to ask questions. Jim Mather will go first.

Jim Mather: I am keen to follow up on Douglas Millican's earlier statement that any debt write-off would move the debt from water-charge payers to taxpayers. I see as somewhat invidious the fact that debt was moved from English and Welsh water-charge payers to all United Kingdom taxpayers. Scottish water-charge payers are also UK taxpayers, so are not we paying twice, given that we must pay 100 per cent of our debt and pay our pro rata share of the English and Welsh write-off?

Douglas Millican: I would have thought that, back in 1996 when the debt of the water authorities was commuted, the burden was probably borne by the whole UK. However, that question is probably better addressed to the Executive.

Dr Murray: As I understand it, the scheme of charges is determined by the minister only when agreement cannot be reached between Scottish Water and the water industry commissioner.

Professor Alexander: Yes.

Dr Murray: Did the current scheme of charges have to go to the minister?

Professor Alexander: No.

Dr Murray: So the current scheme was agreed between Scottish Water and the water industry commissioner.

Professor Alexander: Yes.

Dr Murray: When we questioned the water industry commissioner, reference was made to the balance between the volumetric charge and the standing charge, which has caused a lot of grief, especially among the small business sector in rural areas. Is that about cross-subsidy? Has the current balance come about because Scottish Water feels that the directions make it unable to cross-subsidise between one group of consumers and another?

Professor Alexander: I will ask Douglas Millican to give some numbers on that in a minute, but I will make a point about how the charges were established for the current year. It is important to say that exactly the same position on business charges would have been reached in two years instead of one, if the charges had been spread out. My board's view was that there were so many anomalies in the charges that similar businesses throughout the country were paying that there was a case for moving more quickly to harmonisation. I emphasise that the charges that were levied this year would have been levied next year in any case. That was in the logic of the revenue cap and the strategic review.

Douglas Millican will comment on the balance between volumetric and fixed charges.

Douglas Millican: By way of background to help with answering that question I should explain that, when we considered the charges across the four-year regulatory review period, three factors bore on how customers' charges would change from what they were in 2001-02 under the three authorities to where they would end up in 2005-06. The first was that the level of revenue that Scottish Water required to fund its activities and investment programme would rise from about £845 million in 2001-02 to about £1 billion in 2004-05. That increase in the required level of revenue had to be passed on in charges.

The second issue was around the adjustment of moving to higher fixed charges. The harmonisation of charges had by far the most significant impact on individual customers' bills. When you look right

across the categories of customers, from small water users to major water users, you can see that it was harmonisation of charges—more than either the increase in revenue or the move to greater fixed charges—that had the single biggest impact on the swing in individual customers' bills.

Dr Murray: So it was a consequence of the legislation's bringing together the previous water authorities that had that effect.

Dr Hargreaves: The Parliament voted for that.

Professor Alexander: It should be emphasised that one of the drivers for the creation of Scottish Water was the need to harmonise charges throughout Scotland.

Douglas Millican: On fixed charges, we noted the advice that the commissioner gave to ministers—which was accepted—about the need to move to higher fixed charges. We have followed that advice. However, based on our expectations, this year 21 per cent of our income from metered customers will be raised through fixed charges, and 79 per cent will be raised through volumetric charges. So, although we have moved to much higher fixed charges, the vast majority of our total revenue from metered water customers still comes in by way of volumetric charges. I recognise that behind that there undoubtedly are some very small users for whom the share of their bill that is represented by fixed charges is much higher than that but, at the other end of the spectrum, there are large continuous-process users of water for whom the fixed element is still a relatively small proportion of the total bill.

Dr Murray: I do not know whether that is much comfort to businesses that have one toilet and a kettle.

I have a question on a slightly different area. My recollection is that something like £100 million of the end-year flexibility moneys that the Scottish Executive re-allocated last year came from the water industry. Is that correct?

Professor Alexander: There is a series of misunderstandings about that; I ask Douglas Millican to demonstrate why.

Dr Murray: One of the things that confuses people is the perception that money was given back by Scottish Water. People feel that with all the infrastructure investment that is required, that money should have been retained by Scottish Water.

Professor Alexander: It is a misconception, and Douglas Millican will explain why.

Douglas Millican: The Scottish Executive set its original borrowing consent for 2002-03 very early—long before Scottish Water was formed and before Scottish Water got to grips with what would be the optimal profile of capital investment. One of

the arrangements that we have with the Scottish Executive is funding flexibility within the four-year regulatory review period, to ensure that we can optimise delivery of the capital investment programme and so that we can maximise efficiency in delivery of that programme.

Because we were a new organisation at the start of the review period, the level of investment that we undertook last year was, and that which we will undertake this year is, inevitably lower than the investment that we will undertake in the last two years of the review period. The Scottish Executive has ensured that we are funded for the full value of the regulatory capital allowance of £1.8 billion and, indeed, beyond that if capital inflation exceeds the levels that were assumed at the time of the strategic review.

The Convener: The last question is from Ted Brocklebank.

Mr Brocklebank: I have two questions on pricing. As a Fifer, my ears pricked up when Alan Sutherland referred to the fact that Fife households are paying something like 5 per cent of their disposable income on water charges and sewerage. Is that typical? Is the situation the same in other parts of Scotland? If not, why is Fife in that situation?

Dr Hargreaves: I have not heard that figure of 5 per cent before. In the research that we have seen from the WCCPs, the figure varies throughout Scotland, so I do not know whether that 5 per cent figure is correct or incorrect. As the commissioner rightly said, the issue is cross-subsidy. Do politicians—do you people—want to subsidise and, if so, whom do you wish to subsidise and by how much? Those are political decisions.

The Organisation for Economic Co-operation and Development reckons that when 10 per cent of disposable income, anywhere in the world, is spent on water, it starts to have a serious impact on standard of living so one could argue that spending 5 per cent does not have such an effect. That said, if 5 per cent of someone's disposable income was being spent on water, they would take a great deal more care with water.

The issue of affordability, which underlies Ted Brocklebank's question, is political. Our argument is simple; it should be made clear to people when they pay their bills that they are paying for many things other than the water that they use. They pay for many other people's water, including churches and charities, people in band A housing and people on disability allowance. That practice is not unique to Scotland; it is fairly widespread, although it is more extreme in Scotland. We need to be clear about that publicly so that the small business customer recognises that part of his charge is being spent on things in Scotland other than, as has been said, his toilet and his kettle. It

is important to get it clear in people's minds what is involved in the tariff cross-subsidy.

Mr Brocklebank: Do you believe that Scottish Water has a specific role in alleviating problems like that?

Professor Alexander: No. It is late in the day to raise philosophical issues, but there is a distinction between a tax and a charge. It seems to me that intellectually it is entirely respectable to use a tax for redistributive purposes; however, it is much less intellectually respectable to use a charge for services delivered for redistributive purposes. We can overlay a charge with affordability, as the Executive has done over the past couple of years, but that is not for Scottish Water to decide. If it is to be for Scottish Water to administer the charge, our operational expenditure limit will need to recognise the cost of doing that. That is the key point.

The Convener: I will have to stop the discussion there in case we go too far into the realms of philosophy. I thank the witnesses for coming along.

The committee agreed a remit and timetable on 11 November. I suggest that the reporters draw up another report based on the information that we have heard this morning. They will make proposals for further action.

Fergus Ewing: This morning's session was useful, but I am conscious that the paper that the reporters—Jim Mather and Jeremy Purvis—produced included a list of about 22 different topics. We have covered only about three or four of them today: we have not touched on European Union infrastructure money, which Dr Jon Hargreaves touched on; we have not touched on the costs of replacement of old infrastructure; we have not touched on the use of public-private partnerships or private finance initiatives and Scottish solutions; and we have not touched on business or domestic non-payment or other channels of finance.

It seems to me that we need to widen out and lengthen the inquiry so that we can do more than scratch the surface. We need to hear from a great number of experts, some of whose names have been mentioned today, and to ensure that this can be a thorough-going and full inquiry, which might take much longer than some people estimated. I hope that we can review the matter, perhaps next week.

The Convener: I ask the reporters to reflect on the issues that they have heard about. We have charged them with undertaking the work, so we have to wait for them to produce their report. There are other issues that we need to investigate, so we might take longer than we anticipated. I do not really want to have an extended debate on the matter—we shall wait for the report from the reporters.

Items in Private

The Convener: Item 3 is to seek the committee's agreement to consider in private at our next meeting a paper on commissioning external research for our cross-cutting expenditure review of economic development. Given that the debate will involve our considering the merits of individuals, I suggest that it would most properly be held in private. Do members agree?

Members indicated agreement.

12:58

Meeting continued in private until 12:59.

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