

FUNDING PUBLIC SERVICES IN SCOTLAND

Introduction

Following the publication of its overview paper *Supporting Public Service, supporting public service*, STUC has committed to publishing a number of policy papers covering different aspects of government policy on public services. It will do so in an attempt to influence the decision makers, but also with a view to engaging civic Scotland in a meaningful debate about the future of public services in Scotland.

This first paper *Funding Public Services in Scotland* identifies that our quality of public service provision is influenced by world trends in public spending; by government attitudes to tackling income inequality; by overall levels of public spending in Britain; by the way in which Scotland is funded; by the tax and spend decisions of the Scottish Government; and by the mechanisms it employs to distribute resources. In all cases, STUC sees an argument for change.

Committing to a vision of strong and sustainable public services in Scotland involves taking a critical approach to policy in all the areas identified in this paper and for engaging in dialogue to achieve consensus for reform. Doubtless there will be disagreements and refinements as the discourse develops. Ultimately however, Scotland requires a new vision for future public service provision and the way in which these services are funded is fundamental.

Public spending and economic growth

The growth of social spending through welfare transfers and public service provision in industrially advanced countries cannot be separated from advances in democracy and equality. Generally, social spending began in the late nineteenth century, increased slowly but steadily up until World War II, increased rapidly from then until the late 1970s and has stabilized, and in some cases diminished, since then. This closely matches the advances and then stalling of democratic participation and income equality over the same period.

Since the Second World War, different OECD countries have differed markedly in the percentage of GDP spent on social transfers with the USA and Japan spending least and Nordic countries such as Denmark, Sweden and Finland spending most. The European giant economies of Germany and France have tended towards higher social spending and smaller less economically successful southern European countries such as Greece and Portugal have spent less.

Right wing commentators have variously ascribed the claimed success of the US and Japanese economies to low levels of public spending. Their argument is that a large welfare state drags down growth which in turn chokes off the further

advance of the social spending itself. The problem for those who adhere to this orthodoxy is that the facts do not match the perception.

In his widely acclaimed study of international public spending patterns and growth, "Growing Public"¹ Peter H Lindert states.

"The net national costs of social transfers, of the taxes that finance them, are essentially zero. They do not bring the GDP costs that much of the Anglo-American literature has imagined."

and

"Across countries or over time, the coefficients linking growth to total government size are not negative, even in statistical multivariate analysis ... whether one looks at the levels or at rates of change, one cannot show any clear negative relationship between social spending and GDP per capita".

Later in 2009, STUC will publish its paper, the Public Sector as an economic driver, outlining the ways in which public services are a driver for growth. There is a meaningful public debate to be had on which forms of public expenditure best drive the economy. For the time being it is sufficient to note that, as evidenced by the highly successful Nordic economies, there is no contradiction between substantial public spending and economic growth and high productivity.

Public services and equality

Public services are a significant driver of economic growth but this is not the factor which motivates people to support strong public services. Their primary objective is to maximise positive opportunity and *outcomes* for all.

The previous section made reference to the supposed similarities between low spending countries such as the USA and Japan in relation to growth. However whilst Japan and the US spend similar proportions of GDP on social transfers, they have markedly different outcomes in relation to social well-being. This reflects the interrelationship between income equality and public service provision.

In their recent book *The Spirit Level*, academics, Richard Wilkinson and Kate Pickett use a range of internationally recognised indicators to measure social outcomes in developed countries. The indicators include physical health and life expectancy, educational performance, crime and imprisonment, teenage births, social mobility, mental well-being, drug use, 'trust' and 'happiness'. In every one of the indicators provided, Japan outperforms the USA, and in most cases the

¹ Growing Public: Volume 1, The Story: Social Spending and Economic Growth since the Eighteenth Century

countries are at completely different ends of the scale with Japan having the very best outcomes and the USA the very worst in a number of categories.

Wilkinson argues, entirely convincingly, that this is a consequence of Japan being, in terms of individuals' income, one of the most equal countries in the developed world and the US, the least equal. Japan achieves its equality not through social transfers but through relative wage equality compared to other developed countries. The difference in income between Japan's top 20% and lowest 20% is 4:1, whereas in the USA it is over 8:1

The only countries which can rival Japan's strong social outcomes across this range of indicators, and which sometimes surpass it, are the Nordic countries which achieve similar levels of equality through a combination of better wage equality and higher social spending.

With few exceptions, Wilkinson finds that Britain's outcomes tend towards the US end of the spectrum, with a relatively high level of inequality and relatively poor performance on the social indicators examined. The top 20% in the UK receive over seven times as much in income as the lowest 20%.

The message is clear, whilst there might be more than one way to achieve relative equality – through relative wage equality or social transfers – it does provide the clearest route to national well-being amongst developed countries.

Public Spending - UK and the world

UK public spending has increased as a proportion of GDP since Labour was elected, with the actual increases taking place from 1999 when Labour abandoned Tory spending plans. From a position in 1999 where UK spending as a proportion of GDP was almost 10% below the European average, the UK spent only marginally below the EU average in 2008 and is predicted to marginally exceed the average by 2010. In 2008, UK public spending as a proportion of GDP exceeded that of Germany for the first time in a generation.

The major engine for this change was the historic investment in public services between 2001 and 2005, primarily in the areas of health and education. This investment took place at the same as Britain experienced major economic growth, contradicting general norms whereby spending as a proportion of GDP falls at times of faster economic growth. From the right-wing, there has been much criticism of the 'failure' of the Labour Government to reduce spending at this time thereby missing the opportunity of 'saving for a rainy day'. However Labour's spending was a correct response to two decades of disinvestment in public services aimed at correcting a situation where, particularly in health, the proportion of GDP spent lagged almost all comparable countries.

Is it enough to be average?

Labour's increase in public spending has led to the proportion of children living in poverty dropping significantly during the years of increased investment and the UK has climbed the league tables in relation to GDP spent on per capita health and education. Many of the benefits which will be accrued will only be seen in future decades, just as many of the consequences of Tory disinvestment during the 80s and 90s continue to be seen today.

The first priority therefore is to maintain UK public spending on or above the EU average in the face of the recession.

However there are reasons to believe that in order to keep pace, UK public spending must increase by at least the EU rate and possibly faster.

The UK shows up poorly on measures of comparative income inequality, including in-work poverty. Of European countries of similar size, only Spain has higher levels of in-work poverty. The fall in child poverty rates which were seen in Britain between 2002 and 2006 now appears to have stalled and the proportion of children in poverty with at least one working parent has actually risen since then.

This means that significant levels of the UK's public spending are simply taken up with dealing with the social and fiscal consequences of the high degree of wage inequality rather than driving growth. The large sums of public money spent on childcare and occupational health in Scandinavian countries are testament to the capacity of relative equality to free up public money to drive productivity and further equality – a virtuous circle that Britain would do well to replicate.

Whereas Nordic countries lead the world in investment in child care, the UK continues to spend more than almost any other nation on public order and safety (which includes prison spending) – more even than the US. In this context overall levels of public spending compared to countries such as France and Germany (who spend less on prisons) look less rosy.

Although not related to inequality, the UK also continues to spend more than 2.5% of GDP on Defence (5% of public spending). It also plans to allocate monies from future Comprehensive Reviews to a new generation of nuclear missiles on the Clyde, monies which will entail additional a direct transfer from other public spending priorities.

The Westminster Government should.

- **Commit to equalling or exceeding the European public average and within the overall figure commit to meeting or exceeding the**

spending of comparable economies on health, education and other vital public services.

- **In the new international climate, reconsider its commitment to a new generation of nuclear weapons on the Clyde and to commit to investing future savings in core public services.**

UK public spending and the recession

Public spending as a proportion of GDP will rise significantly during the current recession. This is partly due to slow or negative GDP growth, partly due to the increasing numbers claiming unemployment benefits, and partly due to specific stimulus measures already announced by the Chancellor in November 2008.

None of this however indicates increased spending on core public services. Indeed the most alarming announcement in the Chancellor's pre budget report was of an additional £5 billion in public service 'efficiency savings' in 2011. STUC is not opposed to genuine public sector efficiency measures in which savings are re-invested and democratic accountability and service quality maintained (a detailed analysis of so-called efficiency measures in the UK and Scotland will be undertaken by STUC in a policy paper to be published later in 2009), however the announcement of these previously unheralded efficiency savings accompanied by warnings that public service providers must "tighten their belts" cannot be interpreted as anything other than cuts.

These proposed cuts in public services reflect a pattern established during the recessions of the early 1980s and early 1990s, but are no less worrying for the fact that they have precedent. Many of the negative health, education and employment consequences of previous recessions can be attributed to those very public spending cuts. In particular, the year on year cuts in public services and public service employment during the early 1990s led to massive problems, prompting the need for the incoming Labour Government to act to restore reasonable levels of public spending in key areas such as health and education.

STUC published its Budget submission on April 2009. It argues that the time is right for a further economic stimulus much of which must be directed at short-term measures such as targeted tax cuts for low paid workers and benefit increases; public works programmes; short-time working incentives to encourage employers to retain human capital, rather than dismiss workers; and enhanced support for the unemployed through expanding the capacity of job search and support services such as JobCentre Plus. The latter is important because it must signal a longer term reversal to job cuts in the Department of Works and Pensions, whose frontline workers provide a vital public service and are systematically undervalued by central government.

STUC will also advocate a more general investment in public services to allow public sector employment to be maintained, and enhanced in sectors where it can help drive recovery and mitigate the longer term damage of the recession.

The UK's current fiscal stimulus pack is welcome, but by global standards it is small and relatively short-term in planned duration. Nevertheless, when the costs of bank bail-outs and quantitative easing are taken into account it is clear that the on-cost will be substantial and that it will be necessary for the Government to set out a clear path towards fiscal consolidation. This will be even more vital if, as STUC and many commentators propose, the Chancellor announces further fiscal stimuli on April 22nd 2009.

The Westminster Government should

- **announce a significant additional fiscal stimulus in its 2009 budget incorporating the measures outlined above and committing to maintain investment in core public services.**
- **Reverse its plans for £5 billion in 'efficiency savings' in 2011.**

Public services - who pays?

As argued above, STUC's view is that planning reductions in spending on core public services would be the very worst option in the current economic conditions. Thus the only alternative is to plan for increases in overall levels of taxation, *but increases targeted at those with the ability to pay.*

The Government's temporary reduction in National Insurance Contributions for the less well paid, and increases in the top rate of tax to 45% are both welcome. However a far more fundamental rebalancing of the UK tax system is required.

The past decade has seen a very clear trend towards lower and less progressive tax. The move may have been spearheaded by 'flat-tax' eastern European countries and others such as Ireland but it has certainly not been limited to these. Even in this context, Britain's remains one of the least progressive tax regimes in Europe. Currently, the poorest fifth of UK households pay 36.4% of their income in taxes: 9.5% in direct taxes and 26.9% in indirect taxes. The top fifth pay 35.5% of their income in taxes: 24.7% in direct taxes and 10.8% in indirect taxes.

There are a number of key factors which contribute to this regressive picture.

- Although **VAT** in Britain is a little lower than in most other European countries, its impact is greater where the proportion of those living in poverty is high.
- The **National Insurance Contribution** is a highly regressive tax. The Government's own figures confirm that someone earning £12,000 a year, slightly above the minimum wage, pays £745.80 or 6.21% of income, in

NIC. For those earning £24,000, nearer the median wage, this rises to 8.61%. Because of the artificial ceiling those earning £50,000 and £100,000 pay 6.82% and 3.91% of their incomes respectively in NIC.

- The Chancellor's increase in **top rate tax** to 45% brings the UK into line with countries such as France, Germany and Italy. The fairest countries such as Sweden retain higher top-rate tax levels, though the international trend is definitely downwards. However the fact that there is a general trend toward more regressive taxation should not obscure the fact that it is unjust and a key contributor to income inequality.
- The ability to take their earnings as **capital gains** means that many amongst the highest paid not only pay a lower rate of tax than they would as income tax but altogether avoid National Insurance.
- TUC research suggests that **tax avoidance** by the super rich, the city and UK plc is costing the Exchequer around £25 billion every year. The fifty largest companies almost always pay 5% less tax on average than they declare in their accounts.

The Westminster Government should examine and implement a new tax regime including:

- **Acting to ensure that tax credits and benefit payments provide adequate compensation for the massive negative effect of indirect taxes such as VAT on the poorest decile.**
- **Reform National Insurance Contributions to make it far less regressive.**
- **Review the top rate of tax and the earnings level to which it should be applied.**
- **Reform capital gains tax to remove the attraction for top earners to avoid paying income tax and give consideration to the TUC's Minimum Tax Proposal which would see all high wage earners pay at least 32% in tax.**
- **Implement the proposals of the TUC's report "The Missing Billions" including the introduction of a new law called a 'general anti-avoidance principle' that treats all tax avoidance as unacceptable and therefore open to challenge.**

Public spending Scotland and the UK

The vast majority of public service spending is funded through the Scottish Block Grant determined by the Barnett Formula.

Estimates of the relative advantage or disadvantage to Scotland of the funding system depend on the initial starting point. Those who believe in full fiscal autonomy or independence argue that Scotland is only adequately funded based on its contribution to UK GDP however the argument normally includes a geographical share of North Sea Oil and fairly optimistic assumptions about the

price of oil going forward. Others (normally but not exclusively outwith Scotland) make straight per capita comparisons and conclude that Scotland is particularly well funded to the detriment of regions within England and Wales.

STUC takes the view that the relative fairness of the Scottish block grant settlement can only be calculated on the basis of a needs analysis, which is in itself a difficult and subjective task to undertake. For this reason any hasty move away from the use of the Barnett Formula to fund Scottish public services would be a mistake.

Public spending in Scotland can be separated into four broad streams.

Non-identifiable UK-wide expenditure 'benefiting' Scotland. These monies, spent by Westminster are defined as equally benefiting all citizens of the UK. The largest single spending item by far is Defence. Clearly, overall levels of spending on Defence impact upon the overall spending available to the Treasury and therefore to Scotland.

Expenditure in Scotland in areas of responsibility reserved to Westminster. The main expenditure is on the basket of "welfare" payments, including pensions, unemployment and incapacity benefits, Family Tax Credit, Council and Housing Benefit, etc. Of these, only a small proportion can be affected by Scottish policy (i.e. Council Tax benefit levels depend on Council Tax levels set in Scotland). This expenditure is primarily governed by per capita need and is not affected by the Barnett Formula.

Expenditure in Scotland under the control of the Scottish Parliament and funded by Block Grant according to the Barnett Formula and announced in Westminster Comprehensive Spending Reviews: The vast bulk of the is taken up by spending on social services, NHS Scotland, education, social and care services and transport are the four largest. Much of the expenditure in education and social and care services is administered by local government and currently regulated through the Concordat with local government.

The Standard Variable Rate on Income Tax ('3p in the pound' power), potentially set by the Scottish Parliament, but currently unused, could also provide direct funds to be spent by the Scottish Government on public services and would not be affected by the Barnett Formula.

Expenditure in Scotland under the control of the Scottish Parliament and variable in Scotland:

- Council Tax, set and collected by local government and contributing directly to local government spend; and
- Local business rate, set and collected by the Scottish Parliament and feeding directly into the Scottish budget.

This expenditure is fully devolved and is not affected by the Barnett Formula.

Trends in funding for public services in Scotland

Significant controversy surrounds the effect of the Barnett Formula on future Scottish spending. The Formula was not designed to last for 30 years nor was it explicitly designed to provide convergence. Nevertheless it has endured and its basic mechanism – increasing the block grant only on the basis of changes in population share – suggests that at some point in the future funding for Scottish public services will reduce to a point where it is comparable to the per capita spend across Britain. STUC contends that were such a point to be reached, and unless relative need in Scotland has reduced, the effect of the Formula would be both unfair and to the disadvantage of Scotland.

Whilst it has been generally assumed that convergence is quicker at times of increases in public expenditure (larger rises across the UK applied only on a per capita basis in Scotland) and slower when expenditure increases are small, in practise this may not be the case. Because public services are predominantly provided by people the pay bill predominates as a factor in determining the cost of delivery. In a case where public spending growth is flat or negative but that pay continues to rise with inflation, Scotland would find itself increasingly squeezed in terms of public spending. Various commentators which had previously assumed relatively slow convergence have revised their estimates in the light of the current recession.

The STUC has outlined its proposals for an increase Scotland's fiscal powers short of full fiscal autonomy. These include:

- **Extending borrowing powers to the Scottish Parliament**
- **Reforming the Standard Variable Rate ('3p in the pound') power by widening its application to include higher rates of income and unearned income**
- **Devolving Council Tax Benefit and Housing Benefit to Scotland**

The Scottish Government and public spending

As outlined in the previous section, Scottish Government currently has relatively few levers to adjust overall income and spending levels in Scotland. It may vary business rates and influence levels of Council Tax and were it to choose to do so, could use the Standard Variable Rate to increase or decrease income tax for basic rate tax-payers.

Whilst it has argued strongly for increases in overall UK public spending – based presumably on tax increases – and has been critical of the Scottish financial

settlement and some aspects of the operation of the Barnett Formula in the current spending round, the Scottish Government's own instincts when applied to its own powers, appear to be towards lower revenue raising and lower spend.

Having decided, along with previous administrations not to use the "3p in the pound" Standard Variable Rate, the Scottish Government has chosen to press for year on year Council Tax freezes and to return money to business through changes to the Small Business Bonus Scheme. Whilst it would doubtless argue that both of these measures will be helpful at a time of low demand in the economy, the Scottish Government cannot escape the fact that the overall effect has and will continue be, cuts in public services.

Scottish spending on public services has, and will continue to, lose out to the tune of £170 million per year as a consequence of these two measures. The suspension of the mechanism whereby low Council Tax rises (leading to lower Council Tax Benefit requirement in Scotland) are compensated by the UK Treasury through an increase the grant, also means that any Council Tax freeze effectively reduces inflow of funds to Scotland. Whilst this is hardly the responsibility of the current administration it is an adverse consequence of the Council Tax freeze. If the Council Tax freeze and business rate cuts were reversed, the Scottish Government could meet the calls of the Scottish Federation of Housing Association, STUC and many others for the building of 10,000 new homes for affordable rent in Scotland annually.

Local government taxation

STUC had serious concerns over the SNP Government's Local Income Tax proposals and welcomes the withdrawal of the policy for the duration of the current parliamentary term. Within a basket of income related taxes there is a strong argument for one element to be based on property - whilst property value is not a faultless indicator of wealth or ability to pay, research shows that there is a broad link. It must be recognized that the Council Tax presents particular problems for pensioners which should be addressed through other fiscal means. Overall however, Local Income Tax had major problems in relation to predicted overall funding levels, local accountability and difficulties with collection.

This notwithstanding there is a pressing need for reform of the Council Tax to enhance its relationship with generalised ability to pay. The current banding system limits how much those with very expensive properties have to pay. £400K house pays three times as much as a £40K house not ten times. The banding system needs to change to take account of both changes in the house prices and particularly to ensure more bands at the top and bottom of the scale. Currently the richest fifth of non-retired households pay 2% of their gross income on Council Tax, the poorest fifth pay 5%.

Given Scottish Labour's support for a review of Council Tax banding, the Scottish Government has a clear opportunity to achieve progressive improvements by consensus and it should grasp that opportunity with both hands.

Smoke and mirrors? The Concordat with Local Government

There has been a great deal of head scratching surrounding the Scottish Government's claim that its budgets have maintained levels of spending in key departments, provided a historically strong local government settlement, provided funding for its key policy initiatives and managed to support real terms cuts in Council Tax and small business rates, all at a time where it claims to have received a poor settlement from Westminster.

Whilst some of this 'smoke and mirrors' exercise centres on the use of efficiency savings targets to mask the implementation of cuts in the public sector, the Concordat with Local Government is the prime culprit.

There is much to be said for the empowerment of local government - STUC has for instance supported the devolution of business rates to local councils. However there are two key objections to the current arrangements.

Delivering additional discretion to local government is not delivering increased local accountability. The drive to achieve efficiencies and the general drift towards councils seeing themselves as procurers rather than providers of services has led to an increasing trend towards contracting out, shared services and the use of arms length companies to provide key public services. Given the laudable position adopted by the Scottish Government on the use of directly employed labour in some areas of the Scottish NHS, it is a major contradiction that its own relationship with local government tolerates and even encourages service provision changes which undermine quality and accountability.

The Concordat is not promoting transparency or delivering on key Scottish Government priorities

The Scottish Government enjoys the STUC's support on three of its flagship policies; reduction in class sizes, free schools meals and expansion of pre-school education. However in all three areas there is confusion over funding and local government's commitment to deliver.

Despite the existence of a vast range of outcome indicators, the operation of the Concordat is shrouded in confusion. Despite the Scottish Government's view that free school meals for Primaries One, Two and Three are fully funded through the Concordat, by October 2008, sixteen of the country's 32 local authorities had indicated they would have to cut other services to afford lunches for all pupils in the first three years of primary school.

Equally, the lack of specificity in the Scottish Government's Concordat agreement with local authorities in terms of meeting the class size target by 2011 has led to confusion and massive differences in delivery. The lack of robust monitoring in the Single Outcome Agreements or the concordat agreement about meeting this target has led to local authorities such as Glasgow saying that reducing class sizes is not a priority for them.

Another negative outcome of the Concordat has been the increase in uncertainty for a range of voluntary organizations delivering vital support in our communities. They report that their funding prospects are less secure and many were forced to deliver 90 day notices to staff at Christmas because future employment could not be guaranteed.

Scottish Efficiency Savings

STUC agrees with the Scottish Government that Westminster's planned additional efficiency savings for 2011 constitute a cut in public services for Scotland and the whole of Britain. However, the Scottish Government's righteous anger is somewhat compromised by the apparent ease with which it decided in 2007 to extend public sector efficiency savings in Scotland to 2%. The STUC will publish a more detailed analysis of public sector reform later in 2009, but it is clear that the majority of the efficiency savings thus far have been in cash rather than time savings and effectively form part of the overall funding settlement for public service providers, so that Scottish Government boasts of the 'best ever settlement for local government' take account of the finding and then reinvestment of 2% savings. An alternative approach would be to place an expectation of local government to *improve outputs* i.e. to demonstrate increased quality of delivery but not to deliver hard cash savings. This would make the current settlement look less generous but would meet the objective of improving service quality without promoting cuts in employment levels or encouraging misconceived shared services projects.

Public sector reform and the voluntary and private sectors

The Scottish Government has committed to the increased use of the voluntary sector to deliver public services. The STUC considers that the voluntary sector has a key role to play in delivering dynamic and accountable public services. However, there is currently insufficient distinction between tendering processes which promote voluntary sector rather than private sector provision. Too often contracting out and procurement are being used to drive down cost rather than improve quality. Voluntary sector providers find it increasingly difficult to match public sector pay and service levels – a direct consequence of cuts in funding, poor implementation of best value and poor commissioning processes. The STUC along with UNISON and UNITE and Community Care Providers Scotland

and the Scottish Council for Voluntary Organisations are promoting a Fair Funding Framework to ensure equal treatment for voluntary sector organisations.

The Scottish Government should:

- **Reverse its future commitment to the Council Tax freeze.**
- **Undertake a review of the reform of the Small Business Bonus Scheme with a view to reversing the policy if it cannot identify tangible benefits proportional to the revenue loss.**
- **Engage in immediate discussions with opposition parties with a view to bringing forward reform of the Council Tax.**
- **Review the Concordat with Local Government; assess its effectiveness as a mechanism for delivering the Scottish Government's key election pledges; and engage a far wider range of stakeholders in the debate over appropriate ring-fencing.**
- **Review the operation of its public sector reform agenda with a particular focus on the effectiveness to date of Shared Services initiatives focusing on whether real and sustainable savings are achieved and if they have whether they are at the expense of service quality and/or democratic accountability.**
- **Indicate its support for the voluntary sector joint funding statement and bring forward a timescale for its implementation.**

Public sector capital projects

Public/Private Partnerships have existed for many decades, but it was in Britain and parts of Europe in the 1990s that these partnerships took on a new life in the shape of projects using private finance and private management to build, maintain and operate public sector facilities. The UK developed the use of PPPs under the heading of the private finance initiative (PFI) from the 1990s. This covered road and rail, hospitals, schools and other buildings. PPPs were also introduced in sectors which were not privatised, such as water in Scotland and Northern Ireland.

The majority of projects continue to be carried out through conventional forms of procurement. PPPs account for only 4% of all investment world-wide. Britain and Scotland have the highly dubious distinction of leading the world in PFI/PPP projects with 10-15% of all public sector capital investment since 1996. On 2006 figures, private finance projects in Britain exceeded in both value and number those of all pre-accession EU states *combined*. Over a 20 year period in the UK, 23.2% by value of PFI/PPP projects have been in the health sector, and 15.5% in education, 11.7% in accommodation/housing, 4.2% in waste and water, and 1.5% in other local government services. The proportion in transport has dropped sharply, due to the failure and cancellation of the £5.5billion London

Underground PPP. This single failure represents nearly 10% of all PFI/PPP projects ever signed in the UK

The PFI/PPP initiative has proved to be a costly failure. PFIs have proved more expensive and less publicly accountable. Despite the best efforts of unions it has been an ongoing struggle to protect the conditions of transferred staff and avoid two-tier workforces.

That private sector borrowing is more expensive than public sector borrowing cannot be contested. In tacitly recognising this fact, the proponents of PFI/PPP have argued that the private sector operates more efficiently than the public sector justifying the additional costs involved. However, this is an ideological rather than empirical view. In 2004 the IMF, hardly a world-wide advocate for public ownership, concluded that:

“It cannot be taken for granted that PPPs are more efficient than public investment and government supply of services...Much of the case for PPPs rests on the relative efficiency of the private sector. While there is an extensive literature on this subject, the theory is ambiguous and the empirical evidence is mixed.”

There are two crucial developments which should once and for all herald the end of new PFI/PPP projects.

PFI/PPP and government borrowing.

Regulations governing which projects can be considered as ‘public borrowing’ for the purposes of the Government’s Public Sector Borrowing Requirement (PSBR) have always been opaque. They have served to disguise the fact that the majority of PFI/PPPs are paid for using public funds derived from local or national taxation. (Exceptions include projects such as toll bridges which are funded from payments by direct users alone). When the UK moves to International Financial Reporting Standards in 2009/10, the new accounting rules will see a whole range of existing PFI/PPP projects move “on balance sheet.” The addition of more than £30bn in capital liabilities will, at a stroke, eliminate one of the main advantages of the PFI from the point of view of the Treasury.

PFI/PPP and the recession

Many have already noted the irony that in the current economic crisis public funds may be used to bail out banks, in order that they can lend to the private sector, so that it can invest in public sector capital projects, which it can then rent back to the public sector at a profit. However, the credit crisis may significantly undermine the potential for new PFI/PPP. Andy Rose, the executive director of the UK’s PFI unit, said in November 2008 that PFI projects

can no longer rely on their previous method of raising bond finance, and are now dependent on bank loans which are only available at much worse terms:

“the bond market, which has been the financial structure of choice for large PFI projects over the past 10 years, is now effectively closed to new transactions. This has increased reliance on the banking market...and increased the strain on the project finance banking model.....funding availability is limited and credit margins have moved up... many banks are indicating that the tenor of loans might be shorter.”

Scottish Futures Trust (SFT)

There has been much criticism of the SFT since its announcement over 12 months ago. Some of this criticism has focused on its failure to initiate any new capital projects, with the presumption being that additional projects would have been possible under PPP/PFI. This is not true. The Scottish Government's capital cover budget is fully committed for the current parliamentary term..

However, other criticisms are justified. The SFT model does not meaningfully distinguish itself from PPP/PFI. It is unlikely to be judged as “off balance sheet”; does not resolve risk transfer issues; does not guarantee genuine democratic accountability; does not protect staff from transfer and will not be able to borrow money more cheaply than conventional borrowing. It is for these reasons that UNISON describes the SFT as PFI-lite.

The Scottish government should:

- **Abandon the Scottish Futures Trust and begin to plan future projects, such as those in local government using councils' prudential borrowing capacity, ensuring that its current capital grant process is best designed to encourage the bringing forward of local authority capital projects.**
- **Join with the STUC and others to lobby for immediate changes to the Scotland Act to enable the Scottish Parliament to use prudential borrowing for capital investment, particularly for NHS Scotland.**

The UK Government should:

- **provide capital cover for all previous PPP/PFI schemes coming on balance sheet in 2009/2010 and provide new and higher limits for the Scottish Government so that additional projects can be undertaken using conventional borrowing mechanisms.**