

# The Fabric of Scotland

**Professor John Kay**

**Reform Scotland lecture sponsored by HBOS plc at the Symposium Hall,  
Edinburgh, Monday 22<sup>nd</sup> September 2008.**

I want to raise questions rather than give answers, which will distinguish this talk from most that I give, although I won't be able to refrain from hinting at some of the answers in the course of what I have to say.

But nevertheless my primary purpose is to begin a debate here in Scotland, a debate which I intend to take forward in the Council of Economic Advisers, and which I hope Reform Scotland and others who are concerned with the business and politics of Scotland will also have an opportunity to take forward.

So I'm going to cover a broad canvas – five broad issues that are interrelated, and I think it's inevitable that the solution to each is going to be influenced by the solutions to the others. These five questions are:

First of all, what has happened to infrastructure investment in recent decades?

Second, what have we learnt in that period about the successful and unsuccessful management of infrastructure projects? And we have many examples of both, though it must be said more of the latter;

Third, what is, and what should be the fiscal framework in which a public investment programme gets developed? And that's a question that we need to answer both for the UK as a whole and for Scotland within the UK;

Fourth, how should infrastructure projects be financed? A question that has attracted a disproportionate amount of attention over the last two decades;

And the fifth question I am going to pose is what should be the government structure of hybrid institutions? I'll explain what I mean by that in a bit more detail when I turn to that topic. But I mean an institution that has characteristics of both the private and public sectors, by which I mean a purpose of delivering services with a public interest ethos and motivation. And we have a great many hybrid institutions, and we should be learning in a more systematic way how we make these institutions operate better.

So these will be my five questions, and you'll see that I'll not be able to do more than go through what each one of them raises, and also that we can't get very far in talking about any one of them without talking about the others.

Before I go and do that, I need to start with a couple of definitions, and the first is 'what is infrastructure anyway?' By infrastructure, what I really mean is two things: One is the

plant and buildings they use in the provision of tax-financed services, essentially the public capital stock - schools, hospitals, universities, also prisons, police stations, our town halls, even our parliaments. The plant and buildings of the public sector.

The second category of infrastructure is for essential and widely used services which are basically funded through user charges that are based on regulated access charges. Monopolies whose charges are set under regulation rather than determined by competition in market forces.

And you can see easily enough what I mean by that, if I say that the main examples of them are the infrastructure that is provided for transport services and for utility networks.

In other words, my definition of infrastructure is what is usually meant by infrastructure

I should also say that when I talk about investment, I mean what is usually meant by investment, not that curious practice that has arisen in British politics in the last decade, of calling all public spending investment. It's a practice that started with the present UK government, but I notice has now infected all sides of the political spectrum

### **Investment in infrastructure – a story of decline**

So what has actually happened to investment in infrastructure over the last three or four decades? You find a remarkable picture. These are figures for the UK<sup>1</sup> – we don't have satisfactory figures that I can give for Scotland – but I think we will not find the Scottish picture very different overall, or in detail, with one particular exception that I will come to.

The picture for the UK is that gross public investment, total public investment on infrastructure in the broad sense as I have defined it, peaked in the period 1965-75 at around 10% of GDP having risen fairly modestly but steadily since the Second World War, and all the reconstruction expenditure that the aftermath of that implied. That figure of gross public investment fell to a low of 1.7% in 2000, and since then it has recovered, but not much in historic terms, and it is now about 2.5% of GDP.

You may think that a large part of that effect is privatisation, and some of it is. I reckon that if you look at what has been reclassified, and look at things that were described as public investment in 1970, but are not described as such today, you would add about 2% to that figure. But even if you do that, you see that the bulk of what has happened is a very real, large decline.

So public sector investment - infrastructure spending - has gone down a lot. Looking at it sector by sector, what do we find? If we take the main categories, the first group is the one in which there's been the largest decline of all – social housing. Social housing

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<sup>1</sup> Here Professor Kay refers to the slides that he used to illustrate his talk, as he does on several occasions in this lecture. The slides can also be viewed on the Reform Scotland web site.

expenditure by public authorities and Registered Social Landlords (RSLs) was 2.8% of GDP in 1970. House-building by Local Authorities is now essentially zero. You might have thought that this was the result of privatisation, and of course it is, so far as the existing housing stock is concerned. The large part of public housing stock has been transferred either to owner occupation or to RSL's. But new house-building is similarly in decline. These are the figures for housing completions in the UK over the last forty years. You'll see that in 1968 we built 425,000 houses in the UK, of which about 200,000 were built as social housing, either by Local Authorities or RSLs.

There was a modest increase in the contribution of housing associations to the total, but the private sector actually built fewer houses in 2006/7 (which are peaks in recent years in house-building), than it did in 1968, which was not an untypical figure round about that time.

So if you ask what has replaced public sector house-building in the UK, the answer is nothing. We're just doing very much less house-building than we did. And of course the decline in house building in that period is entirely concentrated in the social housing sector. You might ask "were we building too many houses in 1968?" and arguably we were, rather than refurbishing existing houses. So are we building enough houses now? One way to look at this is to say that new house building represents one per cent of the total existing housing stock, and it's quite hard to think that that figure is high, bearing in mind that it has to provide for replacement, population growth, and the fact that houses are never quite in the place where you want them to be, so that housing has to be transferred from one area of the country to the other.

Is Scotland different? Well Scotland *is* slightly different because historically, or for a longish period, private house building in Scotland was extraordinarily low. You'll see that in 1968 Scotland built pretty much its population share in terms of total housing, but Local Authority housing was a significantly larger proportion of that, and private house building was smaller.

Private house building has now grown, and Scotland accounts for slightly more than its population share of overall UK house building. There is no Local Authority house-building anymore, and Scotland accounts for pretty much its share of total house-building in the UK as a whole, so that Scotland looks like Britain as a whole, having looked very different in the '50s and '60s. But overall, housing is the sector here that has shown the largest decline.

Gas and electricity have also shown a large decline. To a significant degree that is desirable. Gas reached high figures in the 1960's because that is when we built the natural gas network, and basically we only needed to do that once. Electricity is boosted in the late '60s by an extraordinary splurge on power stations following blackouts in 1964/5. we built a very large number of conventional thermal stations, most of which didn't work, but it didn't matter much because we didn't need the electricity, and we built in the end seven advanced gas-cooled nuclear reactor, in a programme I've described

elsewhere as the worst commercial project ever launched anywhere in the history of the world.

It's probably a good thing that we're not doing that now, certainly not in the public sector, but I should expect that taking everything as a whole that we're spending too little on electricity infrastructure.

There's also a big decline in education, and some decline in health.

Communications is the one area of infrastructure that I expected to see an increase, but the truth is the increase in the volume of telecoms investment has been accompanied by a fall in the price of equipment in that sector, with the result that we have stability overall.

In the water sector there is a steady decline to the late 1980's in line with all public sector investment, but since privatisation there's been a fairly marked resurgence from that low level.

The one area in which there has been a substantial increase comes as a surprise to most people who see this data, and that is that there has been a big increase in spending on rail infrastructure. In fact today we're spending comparable amounts on rail and road infrastructure which is quite remarkable since road accounts for more than ten times as many passenger miles as rail, and accounts for slightly less than ten times as many freight miles as rail.

But then the tonnage that travels by rail is very low value tonnage. In fact half of it is coal, so that it's not unfair to say that taken as whole, roads contribute ten times as much to our total transport needs as rail. It makes one wonder why we are spending quite so much on rail, and this is an issue to which we may want to come back to.

The general pattern is of overall rapid and marked decline in infrastructure investment, that has affected pretty much all sectors of infrastructure activity. And we can see it all around us, every day. We see it even more forcibly if we make comparisons with some of the other European countries that have spent markedly more in these areas than we have in the last two or three decades.

### **Infrastructure project mismanagement**

My second story is of the problems of managing infrastructure projects. It's probably an unfortunate thing for Scotland that the signature project of Devolution was the construction of the Scottish Parliament, which must certainly qualify as one of the most badly managed infrastructure projects undertaken anywhere. It's perhaps instructive for us that that happened. You'll recall that the initial costs in the Devolution White Paper were put in the region of £20-40 million, and as we all know the total cost for constructing it was over £400 million.

Cost overruns are a symptom of bad project management. But one should be clear, because there has been a lot of emphasis on cost overruns, that they are neither necessary nor sufficient as evidence of bad project management. Probably the worst examples of cost overruns of any projects anywhere were the Suez Canal and the Sydney Opera House, both of which overran by factors of over twenty. But on the other hand I'm not sure that anyone would now regret that either was built. Nor indeed is it even clear that either could have been built much more cheaply than the actual cost.

The problem arises as a result of infrastructure projects that we plan and undertake which, if we had started with realistic estimates of cost and usage, we would never have contemplated building. It's a very hard to imagine that anyone would have thought of building the Humber bridge or the Tyne and Wear Metro if they had accurate estimates of what it would have cost to build either, or of how great the usage of these pieces of infrastructure would be. And even the Channel Tunnel would have looked a rather dicey prospect on these criteria.

So the first, and perhaps the largest problem of managing infrastructure projects is what people writing about have somewhat euphemistically called 'strategic misrepresentation'. That is that the project sponsors, bluntly, lie about the cost and utilisation of the projects which they're putting forward. I think that Lord Fraser's report on the Scottish Parliament was extremely helpful as a check list of all that can go wrong in the management of infrastructure projects, because all the main things that can go wrong did go wrong. And the first of these was strategic misrepresentation. It's unlikely that even if the Scots Parliament had been constructed in sheds at Loanhead that a parliament building with offices could have been constructed within that projected budget.

The second group of problems is conflicts among contractors and project managers, that Fraser's report illustrates as one of the central features of the Scots Parliament's problems.

The third feature that becomes a difficulty with managing large infrastructure projects is what I describe as 'Too Many Cooks' – too many interest groups and objectives that need to be reconciled in taking it forward.

The fourth is to do with misrepresentation of progress and lack of transparency about how the project is doing. Now that's a slightly two-edged sword, because although it's easy to say one is in favour of transparency in project management, the blunt fact in the public sector is that if you have transparency, that is if you deal with the fourth problem, you encourage the third, Too Many Cooks, because too many people become involved in the project if you give them the opportunity and information to do it.

On the other hand, having read the accounts of the progress of many of these projects, and perhaps having been influenced most by the saga and story I mentioned earlier of the advanced gas cooled reactors, (a project which if it had been better managed would have saved enough money to have had the waste to spend on all the other mismanaged projects we're talking about) the cost of secrecy, concealment and lies that were told during the

course of that particular project were so large that on balance I believe that proper representation of progress and openness about what is going on is a highly desirable feature.

And I must say I've been contrasting the work done in preparation for looking at the these issues, and it's impossible not to be struck by the impossibility of getting any information at all about the Channel Tunnel Rail Link, as opposed to the extraordinarily detailed progress reports that you get on a six monthly basis, and in English, on the progress of a similar High Speed Rail link from Amsterdam to the Belgian frontier of Holland. I've learnt more about both projects from the Dutch government than from the UK one.

And the final problem which bedevils these infrastructure stories is what I've described as 'Great Leaps Forward'. The problem with 'Great Leaps Forward' is that when the public sector (and this is a public sector problem) has failed in a number of areas, especially in technology, the desire is to say that we will 'leap forward' and have some new scheme that is much more advanced, not only than the ones that failed in the past, but than any project that exists in the world.

The nuclear reactor story was of course a good example of that, and another is going on at the moment in the English and Welsh NHS, where the IT project is a classic example of the Great Leap Forward syndrome. We start with a very real problem, which anyone going to an NHS hospital or GP will be familiar with, of the inabilities of doctors to find any of the notes made by themselves, far less any made by their predecessor or another hospital. So then we decide that we need the best IT system in the world, that will enable any information about any patient anywhere to be accessed by any medical professional, and £12 billion later we discover that it's quite a difficult task even if one wanted to have it anyway, which is not at all clear. So Great Leaps Forward are a large part of this problem.

Now I've mentioned before this issue that the assessment of the quality of infrastructure management is very often done according to whether it comes in on budget or not. It's very important that we get away from that as a measure of success. Because that overlooks the question of what the budget actually is in the first place. If the budget is absurd, the fact that it comes in on budget is not something to be particularly proud of. I've mentioned the Channel Tunnel Rail Link, which in some sense was brought in on budget, but the budget makes it the most expensive rail link that has been built anywhere.

Some of you will have been to Terminal Five recently. Terminal Five at Heathrow was after a few hiccups completed, and it is certainly quite a nice place to be, but it cost £4.3 billion. I have some difficulty with that figure, because Jet Blue are just in the process of completing a terminal, at Kennedy airport, which has a similar target capacity in terms of passenger numbers, (although interestingly quite a lot fewer gates), and the budget for it is \$850 million. Now Jet Blue aren't building a Richard Rogers designed building as we're getting at Heathrow, but on the other hand Madrid airport did build a rather iconic Richard Rogers terminal, rather bigger, and that came in at E1.2 billion.

There seems to be a succession of projects in Britain which cost not just more, but startlingly more than one would realistically expect. All of you will know that the currently targeted figure for the third Forth crossing is currently £3-4 billion, which would make it the most expensive bridge, by a very considerable margin, built anywhere ever in the world. The closest rival is the Oresund Bridge, which links Denmark and Sweden. It's a combined tunnel and bridge which is four times longer, and has both road and rail on it, and that cost just over £2 billion to build. The bridge that looks most like, and in design terms is most like, the proposed new Forth crossing is the Millau Viaduct in France. Many of you will have seen it or photos of it, and it is indeed an iconically beautiful bridge, but that cost E410 million to build.

None of the figures I've quoted are exactly comparable, and there are many reasons that provide partial explanations for the differences I've described. But the differences are so large that I think quite a lot of explanation as to why infrastructure projects cost as much as they do in the UK is needed.

Another problem we have here, beyond that of cost overruns, is one to which I've given the name of 'the Hook' - the idea that once a project has acquired political momentum, the estimated cost of it rises by several orders of magnitude. The most elegant example of the Hook is the 2012 London Olympics, which in the run up to the bid was costed at £2.3 billion, until it was subsequently discovered a few weeks after London was awarded the Games that the budget was £9 billion. That is the Hook in very elegant form. Also in problematic form, because we have there a project where the sponsors have no interest in bringing it in within even the now-inflated budget.

But we have nice examples of the Hook in Scotland, in terms of the Edinburgh Tram, for example, which we see worked on every day. It's now budgeted for a bit less than the originally projected £500 million, but surely you must sometimes scratch your head and say "£500 million? For ten miles of light rail from Leith to Edinburgh airport?"

Or the Border Rail Link, which was initially discussed in terms of £25 million (which seems quite pricey even at that), but has now escalated to £300 million, or in that ballpark.

Part of the reason why the Hook is so effective is, I think, that all of us are used in our personal lives to the idea that, if something costs 'x', and we go out and discover that it actually costs ten times 'x', we say "well perhaps it wasn't such a good idea to do that after all." But because of momentum and the way the political process works, people actually take sides. And it's very difficult to say, in the political world, "well I was in favour of this project when it cost £25 million, but now that it's £300 million, we would be much better doing something else, or in the short term actually nothing at all."

There are two lessons I've picked up from looking at the variety of large infrastructure projects and their successes and failures. One is that, for success, engineering-based project management, which is at arms length both from the political sponsors and from the contractors who are actually building the project, is essential. What typically goes

wrong is either too much involvement on the part of political sponsors, or too much control of the project by contractors, especially contractors squabbling with each other for shares of the pie. Successful project managers are typically people who are in neither category.

It's really because Bechtel, the American firm, exemplify these particular skills that they seem to be brought in so often to sort out projects that have gone very badly wrong. For example, the one time the Channel Tunnel was relatively well managed was in the Morton<sup>2</sup> phase of construction, where essentially control was wrested away from a consortium of contractors which had promoted it, and the somewhat abrasive management style brought in by Morton was used to see off the political interference and to discipline the contractors.

Some of the same has been applied by Network Rail to the West Coast Main Line project, another escalation disaster that I forgot to mention in my sad catalogue earlier, where you will recall that it started at £2 billion, jumped in the last dying days of Railtrack to £14.5 billion, was brought back then to something like £8 billion, and will probably come in, in the end, at around £10 - £11 billion, considerably more than the cost that SNCF typically incurs in building an entirely new High Speed Rail line in France. SNCF too is an example of this kind of capability, essentially engineering-based project management which is at arm's length from both politicians and the contractors who actually carry out the work, and it's doubled up by the fact that SNCF has been engaged in repetitive projects of similar character, which I think is the other key to keeping these costs under control.

The fact that leaves us with greatest puzzlement about the British mismanagement of infrastructure projects, which I will simply put on the table and leave with you, is why is it that Britain is quite so bad at managing these projects, when Britain is a world leader in the consulting engineering skills which are called into play in these projects? And I've got to the point of being tempted to wonder if there isn't actually some kind of connection between the two, that Britain is a kind of show case, not for the management skills, but for the engineering skills to be deployed. I discovered, for example, that the Channel Tunnel Rail Link was built to carry freight trains although no freight train has ever run on it, or is indeed ever likely to.

### **The fiscal framework for infrastructure investment**

That brings me to my third subject, the fiscal framework. Let me start by saying there are two parts to this. There's the UK position, and then the Scottish component. The UK situation of the last decade, as we have all been told repeatedly and tediously by the Prime Minister, had two features, the 'Golden Rule' monitoring current expenditure, and the 'Sustainable Investment Rule', which governs borrowing.

These are rules which have faced the very familiar problem of the application of targets across the public sector, and indeed there are equally familiar problems with imposing

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<sup>2</sup> Sir Alistair Morton, Co-Chairman and Chief Executive of Eurotunnel 1987-1996.

targets in the private sector. These are that if you set people targets, you very often find that the targets are met, but the substantive objectives which motivate these targets are not achieved. This is the generalised version of Goodhart's Law, that says any monetary aggregate you target changes its meaning. Anything you target anywhere changes its meaning when you target it. And this had been aggregated in the case of Gordon Brown's fiscal framework by his near pathological insistence that no mistake or failure could occur, and so despite the fact that these rules have manifestly not been met, there has been great resource and energy devoted to asserting that in fact, yes they have. These rules are basically a good idea in principle, but they are not good ideas in the way that they have been applied in the UK. With ultimately very serious consequences in terms of public finances, because we now go into a serious recession with a structural deficit which it is very difficult to see how we can escape from.

At the same time, we've had a shift from purely cash accounting in the public sector to what is called 'resource based accounting', which is an endeavour to distinguish more effectively what is capital and current spending, and in some ways to bring public sector accounting more in line with the private sector. That is in large part a good idea, although it becomes a bad idea when it is used (as it is increasingly) to shoehorn the management of public sector accounting into private sector frameworks that are not in fact appropriate for it.

That is an issue which you may have seen very obviously in the discussion of the last few weeks about what should and what should not go on public sector balance sheets, as a result of the measures taken to deal with the financial crisis. The truth is that it is not very important what does and what does not go on the public sector balance sheet. What does matter a great deal, however, is what it is actually going to cost us as taxpayers to do these things.

So the question we need to keep asking ourselves is: to what extent do expenditure commitments that are currently being made imply higher levels of taxation in the future? And if you frame the question in that way it is perfectly obvious, for example, that everything that has been subject to PFI over the last fifteen years should have been treated from inception in exactly the same way as the same project would have been treated if it had been undertaken entirely in the public sector, because the future taxation consequences are the same, and are independent of the way these projects are financed.

That is the question that we need to be asking. And the other thing that we have learnt over the last decade is that government cannot be trusted to provide honest reports of these kinds of accounting frameworks themselves. That is, government needs to be subject to the same kind of auditing about a true and fair view that, when it works, the private sector is subject to. And we need to consider, therefore, how we set such a system up, whether it's by beefing up Audit Scotland, or establishing an entirely new fiscal policy commission in order to monitor these kinds of operations.

The second part of the issue is the Scottish position. There is within the Scotland Act a prohibition that Scottish ministers are not entitled to borrow. The range of things that

have been defined as ‘not borrowing’ in Britain in the last decade is so wide, that in my view the extent that that imposes a material constraint on the eruptions of the Scottish government is very small.

But we really need to think of the whole issue in terms of its overall relationship with the UK Treasury. In Scotland, no child, and indeed not many grown ups, know exactly what the Barnett formula is, or indeed that there are three components to Treasury control of public expenditure in Scotland. That is, there is a current element, a capital allocation, and also a non-cash element, which relates (though not identically) to the non-cash charges that are made to the Scottish Government. There are also surprising complications that have emerged to do with capital charges, and also to do with VAT. The totality of this, and the essential feature for understanding it is that, for most practical purposes, the Scottish Government continues to be treated in terms of UK government expenditure as if it were an English government department, rather than if it were a government. In the same sense that even local government in the UK is treated as a government.

And that’s really a product of the fact that in the terms of the devolution settlement, Scottish devolution did not change anything very much in this respect. That has quite a lot of implications, the most practical of which, for the moment, is that the real constraints on what the Scottish Government does are in many ways not so much legislative, but an attitude of mind, one that is born from the era before devolution. An attitude of mind that cannot frame or imagine the question that says “if Treasury guidance on a particular matter is such and such, one might say ‘that is very interesting, but so what?’”

But that is actually the question that a properly devolved position not only invites but requires us to be willing to take. We must expect all this evolve. But as it does, the key to any kind of relationship between the Scottish Government and the UK has to be defined by formulaic entitlements and not by matters which are essentially under the discretion of the UK Treasury. It’s like the difference which one has in growing up between the moment at which one is reliant on pocket money to the moment when actually one has one’s own assets and earnings. And as everyone in this room knows, that transition is a key element in growing up, but it is the phase of growing up that the process of devolution in Scotland has not yet quite reached.

Going beyond that, I think it is obvious enough what the future has to be: on the one hand the Scottish Government is entitled by a formula to a proportion of UK tax revenue, that the Scottish Government has its own borrowing power and manages its own capital expenditure programme, and on the other hand we have to grow up in terms of management of our own affairs to the point where we are no longer quite so seduced by projects like the Edinburgh Tram and the Border rail link.

## The financing of infrastructure projects

Fourth question, how should infrastructure projects be financed? This comes up against the dreaded PFI. PFI has not been a happy story in Scotland – we could discuss the Skye Bridge, the Edinburgh Royal Infirmary, and Seafield treatment works, and one could more or less leave it at that. But as for a more sophisticated analysis of the problems, they are to with the business of binding up finance and all construction facilities contracts together in one package, which has proved expensive, which lacks flexibility, and which also confines Scottish firms essentially, in most cases, to subcontracting roles.

I don't want to engage in a post mortem of that, although mortem may still be some way away. I want instead to look primarily at the past to derive pointers to the future. The popularity of these arrangements derived principally from the coincidence of interests in the project finance industry in finding new markets, and the government pursuing off-balance sheet finance. But while project finance originated in the private sector's search for new financing mechanisms (which was in the first instance about how to finance oil development), the public sector's real need was not (as the oil industry's was), for finance, but for project management skills.

In the oil industry, for example, the large companies had the project management skills, and it was genuinely the money that they wanted. On the other hand the one thing government really does have a comparative advantage in doing, as the last few months have shown us in spades, is borrowing. Government is much the best borrower anywhere. And what PFI has done is to develop skills in structurally complex financial transactions and contract specifications, but has done little to reinforce, and may actually have diminished, public sector skills in project management, which are actually the skills that we really need.

There's also fundamental confusion about the sources of capital and the methods of provision of capital. It's very often said that the merit of these arrangements is that they make new sources of capital available. But the truth is that a) government doesn't need new sources of capital, and b) that they're the same sources of capital anyway. In the end the money comes from long term investors, primarily pension funds, and it's paid for by taxpayers. One can intermediate that in various ways, but that's the fundamental reality. Intermediation imposes costs, although there may be compensating advantages, especially if project management is better. But the truth is there is not much reason, taken as a whole, to think that project management *has* been better.

Then we get to what in a way is the key point of the evening. That is that the price of plain vanilla government financing is today probably lower than it has been at any point in economic history. A Scottish government, any government, could borrow in Sterling today at about 0.5% real interest rates for thirty to fifty years. It seems rather unfortunate, given the infrastructure numbers with which I began, that were not actually going out and doing it.

We might come, then, to Scottish Futures Trust, as a mechanism for actually achieving some of this. What we want from that arrangement is a series of things. Firstly, to promote infrastructure investment, second, a body with some kind of public interest objective, thirdly a mechanism for facilitating financing arrangements, and finally, most importantly, a body that will develop for the Scottish public sector the expertise in capital project management and facilities management outsourcing that PFI has to some degree provided, and which we need to make available effectively to the public sector.

SFT, which was a half formulated idea of this government in opposition, is something that has made depressingly little progress over the last year, but I'm hoping that with the appointment of a high profile chairman<sup>3</sup> in the last week or so, that we can start making more meaningful progress in relation to doing that. The simplest role that such a body could play would be to become, in effect, the SPV in PFI type arrangements. But more broadly, I would like to see it as the owner and lessor of assets to public bodies on a wide variety of different and more flexible terms than have so far been available.

SFT could also buy back some of the more egregious existing PFI's, and it's capable of also being a lender, or although the Public Works Loan Board is currently a lender on such attractive terms that its very hard to see why it might want to be so. But there are a range of things that SFT could do, that it can start to begin to explore, in the light of what I've been saying earlier.

### **Hybrid institutions**

And then let me very briefly address the last of my five headings, which is something that description of an SFT poses for us directly. By 'hybrid institutions' I mean organisations that provide services (and so require business management skills), but whose interests include public interest concerns, and whose revenues are not normally earned in competitive markets. We have absolutely lots of hybrid institutions of this kind in the UK and Scotland. This is just a very illustrative list of some of the things that fall into that category<sup>4</sup>. What you'll notice if you go down that list, is that for almost every single one, we have a different government structure, a different financing structure, and a different regulatory structure. And all I want to do this evening is to make the rather modest proposal that we start to see what lessons we can find in relation to which of these work well and which of them work badly.

We need to look at that under three interrelated headings which every one of these requires us to pose:

Firstly, what is the governance structure, who appoints the management and to whom does it report? Second, what's the financial structure? How is equity provided, either implicitly or explicitly (and any body that trades in any sense has got to have a modicum of implied or explicit equity in it)? And finally what, if any, external regulation exists? You'll see that if we go back through that list, we've answered all of these questions in

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<sup>3</sup> Sir Angus Grossart.

<sup>4</sup> This comment refers to Professor Kay's slides.

one way or another for all of them, but we've answered it in a whole variety of different ways. So if we're to manage the set of infrastructure activities which I've been describing better, we need to develop a set of well run hybrid institutions in order to do it. And that structure is what interrelates and brings together the whole variety of issues which I've been describing.

I said at the beginning, then, that what I was going to do was to paint a very broad canvas, and that is what I've tried to do. We're in a position in the UK today where political debate at Westminster has in a very real sense ground to a halt. It's very hard to find any new thinking at that level going on. I remember a friend of mine, a Labour party historian, saying that before the 1997 election what Labour had realised it needed to do was to be as like the Conservatives as possible, without being the Conservatives. Today it seems we have a rather neat reversal of that position, where the Conservatives either have no ideas, or their position must be as like the Labour government as possible while not being like the Labour government, and therefore not suffering the way it suffers.

In Scotland the position is different. We have the beginnings of - I don't really like the First Minister's phrase a 'national conversation' - but at any rate we now have an opportunity to ask questions for ourselves and on our own (and I've hinted at various points in this talk this evening at the ways in which we really haven't quite grown up enough in Scotland yet to be willing to do that). We have an opportunity on the kind of issues that I've been describing to have our own debate and arrive at our own answers in ways that I think will have lessons for people outside Scotland, but tonight I want us to start the process of debating within Scotland.

Thank you very much.