UNISON
Scotland

# The Scotland Act 2012:

# Bond issuance by the Scottish Government

**UNISON Scotland's response to the UK Treasury consultation paper on bond issuance by the Scottish Government**

**September 2012**

## Introduction

UNISON Scotland welcomes the opportunity to respond to the HM Treasury consultation that seeks to gather views and evidence on the costs and benefits, of granting Scottish Ministers the power to borrow by means of bond issuance for capital expenditure.

UNISON is Scotland's largest public sector trade union representing over 160,000 members delivering public services.

## Background

Under the Scotland Act 2012, Scottish Ministers will be able to borrow to finance current spending:

a. within year, to provide the Scottish Consolidated Fund with enough balance to ensure cash-flow when taxes are devolved and to manage excessive in-year volatility of receipts;

b. across years, to smooth any differences between outturn receipts from devolved taxes and their forecast, up to a total of £500 million total current debt; and

c. on an annual basis borrowing will be capped at a level which is sufficient to deal with forecasting errors in normal times: £200 million.

From April 2015, when Scottish Ministers take control over certain revenue streams, Scottish Ministers will be able to borrow to fund capital projects for the first time.

The power will be transferred to Scottish Ministers in phases:
a. from 2011-12, Scottish Ministers are able to make pre-payments to fund early work on the Forth Bridge Replacement Crossing;

b. from 2015-16 Scottish Ministers can borrow up to 10 per cent of the Scottish capital budget in any year to fund additional capital projects; approximately £230 million in 2014-15; and

c. from 2015-16, the overall stock of capital borrowing cannot exceed the limit set out in the Scotland Act 2012 (at present £2.2 billion, with a power provided to raise, but never lower this limit below £2.2 billion).

These new powers will be subject to Treasury controls. They argue that control of borrowing is central to fiscal stability and Scotland gains from this because without such a fiscal strategy and framework, Scotland and the rest of the UK could face higher interest rates and borrowing costs.

The primary source of borrowing is the National Loans Fund (NLF). However, to allow for greater flexibility in respect of capital expenditure, the Scotland Act 2012 also provides for Scottish Ministers to borrow by way of loans from commercial banks, subject to the condition that the Scottish Government's Accounting Officer is satisfied that this represents good value for money for the UK public sector as a whole.

**UNISON Scotland response**

UNISON Scotland has long argued that the Scottish Government should have borrowing powers including bond issuance. We made the case in our submissions to the Calman Commission as follows:

"UNISON Scotland believes it is vital that the Scottish Parliament has borrowing powers. Indeed it is illogical that local government in Scotland can have such powers (established by an act of the Scottish Parliament in 2003) but that the Parliament itself does not. Borrowing powers would mean that the Scottish Parliament would have much greater scope in planning and funding efficient investment in Scottish public services such as health and education without having to rely on the discredited PFI methods which have been extensively and expensively used in the past."

We recognise that this consultation is very firmly consulting in the context of devolution with no reference to bond issuance under independence.

UNISON Scotland believes that the consultation has some significant limitations, primarily because it is not seeking views on the amount to be borrowed by this mechanism. Any bonds issued have to be within the limits imposed by the Scotland Act 2012's overall limits on borrowing. At present these are set at 10% of the Scottish capital budget (around £230m in 2014/15) subject to an overall limit of £2.2bn.

The paper argues that controls on borrowing are necessary for the UK's fiscal credibility that also benefits the Scottish economy. We do not agree. We believe that these controls reflect the Treasury's desire to control spending rather than any perceived economic benefit. Scotland's borrowing, as with local government, is marginal to the UK as a whole and there are other, more appropriate ways to control borrowing by the Scottish Government.

These controls should simply be prudential borrowing, i.e. that the Scottish Government can fund its capital costs from current revenue. However, for the purposes of this consultation, bonds would be included in the total borrowing limits in the Scotland Act. So the 'moral hazard' or risks the consultation paper emphasises would be minimal. It is somewhat ironic that the paper highlights the additional cost of commercial borrowing, as that is precisely what the UK and Scottish governments have been doing for years through failed PPP schemes.

The most important control is democratic accountability. The Treasury simply ignores the fact that the Scottish Parliament has to approve the Scottish Budget. MSP's are democratically accountable and are unlikely to approve reckless expenditure, funded by borrowing, which would have to be paid for by the Scottish taxpayer. The consultation paper treats the Scottish Parliament as if it was a small voluntary organisation that needed its hand held.

This power has to be viewed in the context of the Scotland Act 2012's aim to devolve greater control of Scottish revenue raising. From April 2016, the Scottish Parliament will move from raising less than 15 per cent of its own budget to around 30 per cent. This will be achieved through the new Scottish rate of income tax (the 10p variation), devolution of land tax and landfill tax, the power to create or devolve other taxes, new borrowing powers and a Scottish cash reserve to manage volatility in devolved taxes. In cash terms, Scottish Ministers will control over £6 billion of tax revenues and they intend to establish a Scottish version of HMRC to administer this. Full borrowing powers including the option of bond issuance has to be viewed in the context. They are the normal financial tools any government with this level of responsibility would expect to have.

UNISON Scotland believes the power to issue bonds should have been introduced with the other Scotland Act powers. The consultation paper is predictably negative about this power and this reflects the conservative approach of HM Treasury to borrowing outwith central government. It is fair to state that bonds can be more expensive than the NLF and that is why local government rarely uses their powers to issue bonds. However, that may not always be the case and the Scottish Government should have the option to use bonds.

The English Local Government Association has been taking a renewed interest in bond issuance. Their Programme Director for Finance reported this summer on plans to create a bond agency that would help diversify the sources of borrowing for councils, which are currently vulnerable to changes in the PWLB rate. The 'terms of trade' of borrowing from the board, including interest rates, have changed six times in the past two and half years. Such 'chopping and changing' was 'very awkward' for town halls trying to develop long-term plans. He said councils typically borrow £5bn annually over a 20-year average duration. So the 2010 rise in the PWLB rate to 1% above government gilt rates would increase their total borrowing costs by £1bn. It was this decision that led some authorities, as well as the LGA, to examine the potential for borrowing using bonds.

Bonds are a long term source of finance and allow access to wider pool of lenders. Importantly, these include the public and pension funds, giving a sense of civic pride in infrastructure projects. For this reason we believe that they could be particularly useful in financing capital investment by Scottish Water. Network Rail uses bond finance and because they are guaranteed by the government they attract AAA rating. Bonds at sub-sovereign level are common in the US, Canada, Germany and elsewhere across the world. The problem of a cost premium can be addressed by an explicit government guarantee. This is reasonable because central government is placing controls on the level of borrowing using this and other powers.

## Conclusion

This HM Treasury consultation paper makes a grudging case for bond issuance and sets against that every possible negative scenario Treasury officials could possibly find. However, within their self imposed constraints these risks are marginal. The gains from bond issuance may not be huge, but it is a worthwhile addition to the Scottish Government's financial powers.

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