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Infrastructure (Financial Assistance) Bill

Bill 66 of 2012-13

RESEARCH PAPER 12/54 12 September 2012

The *Infrastructure (Financial Assistance) Bill* was introduced to the House of Commons on 6 September 2012. The legislation would allow the Government to provide financial assistance of up to £50 billion in support of infrastructure investment. The limit could be increased by order. The Government would have to report to Parliament on any commitments made under the Bill's provisions at the end of each financial year.

This briefing has been prepared to inform the Second Reading debate on the Bill.

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Contents

Summary **1**

1 Introduction **2**

2 Background **2**

2.1 Infrastructure definition 2

2.2 Infrastructure and the economy 3

2.3 Infrastructure investment in the UK 4

2.4 Construction industry statistics 6

Infrastructure 7

House-building 8

Split between public and private investment 8

3 Barriers to private sector investment **9**

3.1 Access to finance 9

3.2 Pension fund investment 10

4 Government policy **11**

4.1 Pension and insurance fund investment 12

4.2 The UK Guarantees scheme 12

4.3 Comment and reaction 14

5 The Bill **15**

5.1 The requirement for legislation 15

Fast-track procedure 16

5.2 Impact of the Bill on the public finances 16

5.3 Clause 1: Expenditure on financial assistance for the provision of infrastructure 17

5.4 Clause 2: Limit on expenditure and liabilities 18

5.5 Clause 3: Reports 19

6 Further information **19**

Summary

The *Infrastructure (Financial Assistance) Bill* allows the Government to provide expenditure and liabilities on financial assistance of up to £50 billion in support of infrastructure investment.

Infrastructure investment is seen as a way of encouraging growth in the UK economy. The Government is hoping to increase the development of infrastructure in the UK by encouraging the private sector, including pension funds, to invest. In theory, infrastructure investment should appeal to the private sector as it is a can provide a long-term and stable income stream. In practice private investors can be deterred by the high risks involved in the construction phase of projects. This is especially apparent in sectors which use new technologies such as renewable energy. In addition, access to finance has been restricted by the financial crisis. Private investors can also find it hard to gain access to relevant expertise in identifying projects and associated risks.

In July 2012, the Government announced the UK Guarantees scheme to "accelerate and bring forward investment in major UK infrastructure projects in response to difficult market conditions". The *Infrastructure (Financial Assistance) Bill* legislates for these guarantees but also provides for other sorts of financial support for infrastructure investment.

The Bill defines infrastructure widely, including not only utilities and transport facilities, but also housing, health and education facilities, and court and prison facilities. Financial assistance not only includes the provision of guarantees, but loans or "any other kind of financial assistance (actual or contingent)". The financial assistance can be given under the legislation not only for the construction of new infrastructure, but also for the operation and repair of existing infrastructure. The legislation would allow the £50 billion cap on spending to be increased by order at any time. The Bill requires HM Treasury to report to Parliament in relation to the legislation at the end of each financial year, starting from the 31 March 2013.

The Explanatory Notes indicate that the Government intended to fast-track the legislation, with all Commons stages to take place on a single day. The Business Statement made on 6 September announced that the Second Reading would take place on 17 September, with no mention of the Committee Stage. The Programme Motion tabled subsequently indicated that the Bill would not be fast-tracked, but its Committee stage would be taken on the floor of the House with Third Reading to take place the same day.

The Bill extends to the whole of the UK and will come into force on the day it receives Royal Assent.

1 Introduction

The *Infrastructure (Financial Assistance) Bill 2012-13* (the Bill) was introduced in the House of Commons on 6 September 2012. Its Second Reading is scheduled to take place on 17 September.

In July 2012 the Government launched the UK Guarantees scheme; the Government stated it would guarantee up to around £40 billion of projects from a range of sectors which were ready to start construction in the next year (subject to certain criteria being met).

The Bill authorises expenditure incurred by government in connection with such support. The Bill makes provision for a total of up to £50 billion of guarantees, expenditure and liabilities. The Treasury has indicated that the additional £10 billion of this funding will be used to guarantee new house-building.[1] The Bill is not about the provision of infrastructure as such, it is solely concerned with the financing of such projects.

2 Background

2.1 Infrastructure definition

There is no single definition of "infrastructure". The *Economist* describes infrastructure as "the economic arteries and veins":

> Roads, ports, railways, airports, power lines, pipes and wires than enable people, goods, commodities, water, energy and information to move about efficiently.[2]

The Oxford Dictionary of Economics defines infrastructure as:

> The capital equipment used to produce publicly available services, including transport and telecommunications, and gas, electricity, and water supplies. These provide an essential background for other economic activities in modern economies… Infrastructure services are generally either provided or regulated by the state.[3]

The Government's *National Infrastructure Plan 2011* refers to infrastructure as:

- major roads, rail, airports and ports;
- electricity and gas;
- communications;
- water and sewerage;
- waste; and
- flood defences.[4]

The Bill defines infrastructure more widely. It sets out a non-exhaustive list of sectors within the construction industry:

- water, electricity, gas, telecommunications, sewerage or other services;

[1] HM Treasury, *Government publishes legislation to help accelerate major infrastructure investment and house building,* 6 September 2012
[2] Matthew Bishop, *Economics: An A-Z Guide,* 2009, p167
[3] John Black et al, *Oxford Dictionary of Economics,* 2009, p229
[4] HM Treasury, *National Infrastructure Plan 2011,* November 2011, p17

- railway facilities (including rolling stock), roads or other transport facilities;
- health or education facilities;
- court or prison facilities; and
- housing.[5]

2.2 Infrastructure and the economy

As well as having its own economic production value, infrastructure development supports various kinds of economic activity and helps the economy work more 'efficiently'. This benefits other industries and households throughout society. The stock and quality of infrastructure within an economy is considered by many to be critical to promoting growth and economic development:

> Evidence shows that investing in economic infrastructure is important for growth and that, for example, building better transport links and energy generation capacity can have a stronger positive effect on GDP per capita than other forms of investment.[6]

The *National Infrastructure Plan 2011* gives example of some of the positive effects of infrastructure investment for the economy, such as higher productivity, employment and demand:

> - increasing output per hour [productivity], including by enabling:
>   - businesses to sell products to customers more efficiently, e.g. through quicker and cheaper transport of goods, services or data, or lower costs of production;
>   - businesses to produce higher value products, including new intellectual capital, e.g. through improved facilities for research and innovation; and
>   - businesses to access larger markets, e.g. through improved links between production centres and ports/airports or through internet sales;
> - increasing the number of effective hours worked each year, e.g. by reducing unproductive time and reducing travel times;
> - increasing the employment rate, by enabling a greater proportion of the population to participate in the economy, e.g. through improved transport or communication links between suburban and rural areas, and city centres;
> - increasing aggregate demand during the construction phase of projects, acting as an important source of employment, skills and innovation in the UK upon which firms can generate export opportunities, particularly to emerging markets;
> - unlocking additional investment that relies on the new facilities in order to be viable, e.g. the impacts of enhanced transport connectivity; and

5 *Infrastructure (Financial Assistance) Bill 2012-13*, Clause 1(2)

6 *ibid.*, para 1.2

- attracting international investment (and retaining within the UK activity that might otherwise be placed overseas) by influencing decision-makers whose locational decisions will be influenced by the quality and reliability of infrastructure.[7]

The failure to provide appropriate infrastructure can create 'bottlenecks' which reduce the opportunities for promoting economic growth. Alleviating such bottlenecks through investment in infrastructure projects, such as roads and airports, can reduce transport costs while ports and other logistic infrastructure reduce the cost associated with trade, all of which improve the competitiveness of UK business. This linkage between the economy and infrastructure is multi-dimensional: economic growth provides both the need for, and the resources to fund, various types of infrastructure.[8]

Although the net economic benefit of infrastructure projects varies (not all infrastructure projects provide positive benefits, for example Chernobyl) most economists accept that infrastructure projects, appropriately analysed and subject to cost-benefit analyses, usually promote economic growth.

Large infrastructure projects have been particularly attractive to governments at times of recession and economic spare capacity. Roosevelt's response to the Great Depression involved large infrastructure projects while the post-war Atlee government also announced major public-works programmes to revitalise the economy. As an economic commentary argues:

> [...] in the context of the recession, infrastructure is a good example of the sort of stimulus spending which makes sense because it rebalances the economy. Investing in infrastructure is a much better strategy than increasing debt to drive up consumption again.[9]

2.3 Infrastructure investment in the UK

There is evidence of a lack of infrastructure investment in the UK and of poor co-ordination between different parts of it. As Dieter Helm of Oxford University has written:

> Few would choose to locate in Britain because of its infrastructure. Much of it needs renewal or replacement. It is also increasingly overtaken by technological progress and the new environmental constraints. Britain's infrastructure is not fit for the digital age and much of it is very carbon-intensive.[10]

A paper written by the Institute of Fiscal Studies (IFS) in 2002 summarised public investment in infrastructure between the 1970s and 1990s as follows:

> British public investment has declined sharply both as a share of GDP and as a share of government spending since the 1970s. Only part of this decline is explained by privatisation, which transferred some public investment to the private sector. More important was the very large and permanent reduction in public house-building between the mid-1970s and the early 1980s. Between the late 1980s and the early 1990s, the rate of public investment recovered somewhat, but after that time it declined again, reaching a record low in 1999 […].[11]

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[7] HM Treasury, *National Infrastructure Plan 2011,* November 2011, para 1.3

[8] Canning & Pedroni, *The Effect of Infrastructure on Long Run Economic Growth*, November 2004

[9] Dieter Helm et al., *Delivering a 21st Century Infrastructure for Britain,* 2009, p11

[10] *ibid.*

[11] "Trends in British Public Investment", *Fiscal Studies,* 2002, vol. 23, no. 3, pp 305–342

The IFS also noted that the then Labour Government planned to increase infrastructure investment, but that levels looked set to "remain low by historical standards" for some time to come.

The Labour Government's plans for increased infrastructure spending were incuded in the *Spending Review 2002*. It would be "providing substantial new resources to improve the nation's infrastructure and to support efficient private sector investment".[12] This was followed by further plans to increase public sector investment in the *Spending Review 2004*:

> In 1997, public sector net investment (PSNI) stood at just £4.9 billion – 0.6 per cent of GDP – the lowest level for over a decade. Investment in public services had been on a declining trend since the mid-1970s, resulting in falling standards in the quality of public service assets. The Government is committed to reversing this under-investment in the nation's infrastructure. In this Spending Review, PSNI will increase to 2¼ per cent of GDP by 2007-08. This will lock in the improvements seen in public service assets since 1997 and ensure that the country has the infrastructure needed to drive increases in productivity.[13]

The Government's *National Infrastructure Plan 2011* acknowledged that investment had lagged behind "the needs of a growing population" and that "opportunities to maximise infrastructure's potential as a system of networks have not been exploited". It continued:

> Most importantly, the UK has never before had a long term plan for maintaining and improving its infrastructure. To remain globally competitive, the UK needs to address these failures and develop an infrastructure capable of supporting a dynamic, modern economy.[14]

In its inquiry on the 2012 Budget, Dieter Helm told the Treasury Select Committee that:

> On the one hand, it is extremely welcome that infrastructure has become part of a Budget, and significant enough for the Prime Minister to make a speech about it. But the scale of the shortfall on infrastructure investment against the policy still leaves a pretty big gap […]. So the gap between what needs to be done and what is being done remains very large. It is a good news story that it is finally being taken seriously, but we are not anywhere near closing up those gaps.[15]

The chart below shows that UK infrastructure spending (on utilities, transport and communications) has lagged behind the average of 18 OECD countries since around 2000:[16]

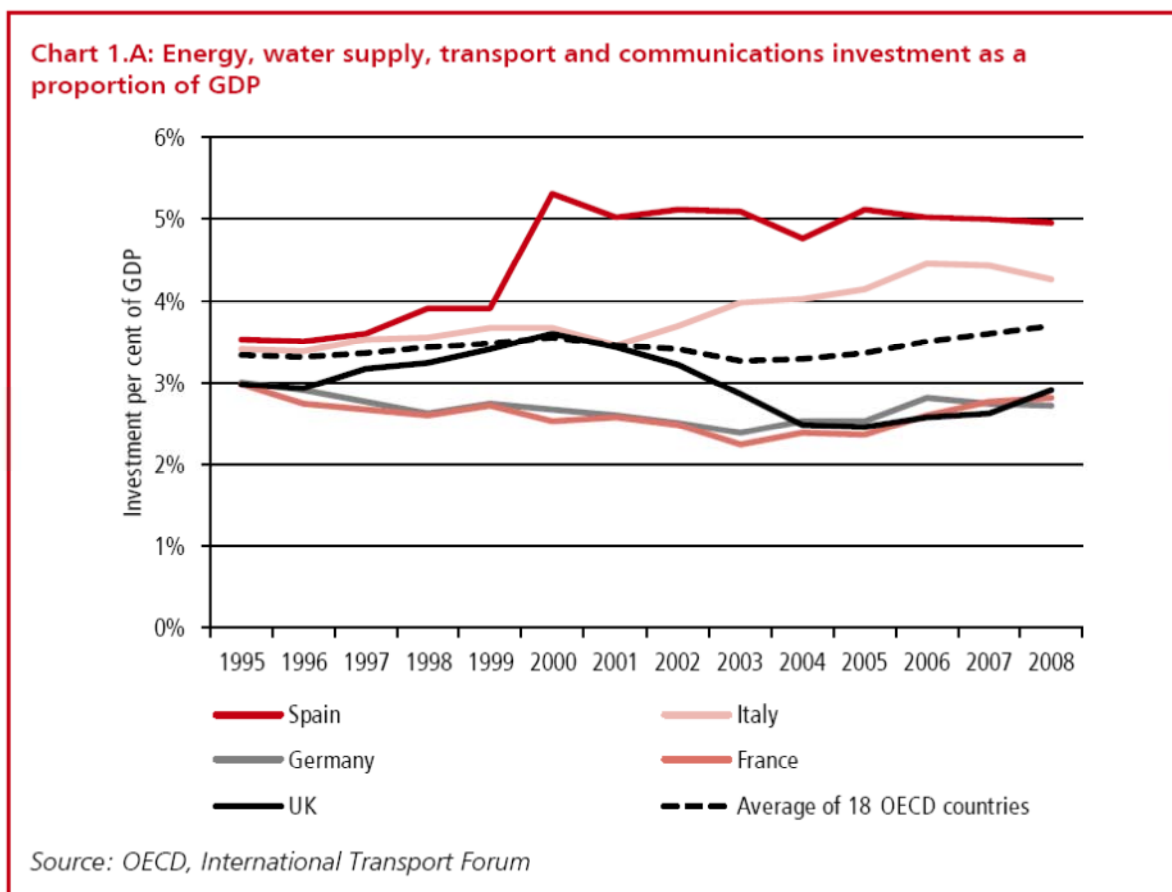
[12] HM Treasury, *Spending Review 2002*, para 2.33

[13] HM Treasury, *2004 Spending Review: Stability, Security and Opportunity for All: Investing for Britain's long-term future*, 2004, para 4.23

[14] HM Treasury, *National Infrastructure Plan 2011*, November 2011, p5

[15] Treasury Committee, *Budget 2012*, 17 April 2012, HC 1910 2010-12, para 132

[16] HM Treasury, *National Infrastructure Plan 2011*, November 2011, p14



The World Economic Forum (WEF) Global Competitiveness Index and the World Bank's Logistics Performance index rank, amongst other things, the infrastructure performance of various economies. The 2012-2013 Global Competitiveness Index ranks the UK in 24th position in the world on overall quality of Infrastructure – up from 28th place in its 2011-2012 index.[17] The World Bank's Logistics Performance Index 2012 ranks the UK's infrastructure as 16th in the world.[18]

2.4 Construction industry statistics

The Office of National Statisitcs (ONS) publishes data on the value of new orders in the construction industry obtained by main contractors in the UK. This is shown for 2011 in the table below:

[17] World Economic Forum, *Global Competitiveness Index 2012-2013 data platform* as accessed 10 Sept 2012
[18] World Bank, *Logistics Performance Index databank* as accessed 10 Sept 2012

Value of new orders in the construction industry by type of work, 2011

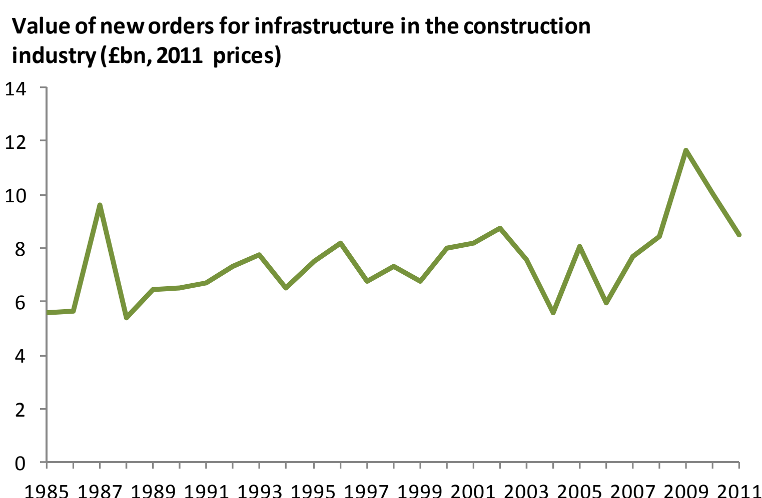
	£bn	% of total	% public	% private
Housing	13.2	29%	20%	80%
Infrastructure	8.5	19%	31%	69%
Schools, colleges and universities	6.4	14%	78%	22%
Offices	3.9	9%	14%	86%
Agriculture, Miscellaneous	3.4	7%	38%	62%
Entertainment	3.1	7%	22%	78%
Garages, Shops	3.0	6%	2%	98%
Industrial	2.3	5%	7%	93%
Health	2.1	5%	63%	37%
Total	**45.9**	**100%**	**31%**	**69%**

Source: ONS, *New Orders in the Construction Industry,* Table 5

The table shows that in 2011, 29% of the value of new orders from main contractors in the construction industry was accounted for by house-building, with infrastructure accounting for 19%.

Infrastructure

The total value of new orders from main contractors in the construction industry for infrastructure projects is given in the chart below:[19]



ONS statistics on new orders in the construction industry include water, sewerage, electricity, roads, railways, harbours, communications, and gas under their infrastructure heading. In 2011, the total value of new orders for infrastructure construction was £8.5 billion, down from a peak of £11.6 billion in 2009.

The largest proportion of the value of new orders in the construction industry within the infrastructure sector in 2011 was accounted for by spending in the railway sector (£3.3 billion or 39% of the value of all new orders), followed by the electricity sector (£1.8 billion or 22% of the value of all new orders).

[19] Sources: ONS, *Value of New Orders in the Construction Industry*, Table 5; HMT, GDP Deflator as accessed 7 September 2012

Infrastructure as share of total value of new orders in the construction industry, 2011

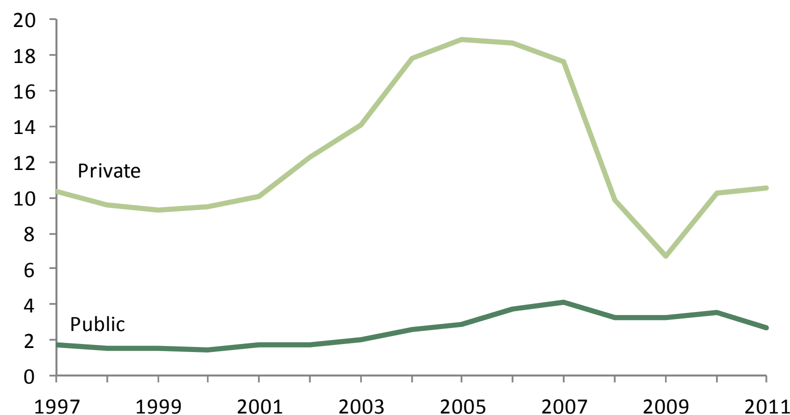
	£bn	% total infrastructure	Infrastructure as % total construction
Railways	3.29	39%	7%
Electricity	1.84	22%	4%
Roads	0.97	11%	2%
Other	0.93	11%	2%
Water	0.89	10%	2%
Sewerage	0.37	4%	1%
Harbours	0.21	2%	0%
Total	**8.50**	**100%**	**19%**

Source: ONS, *New Orders in the Construction Industry,* Table 5
Notes: Other includes gas, communications and air

House-building

The recession which followed the financial crisis in 2007 had a large impact on house building in the UK. The value of new orders in the construction industry from the private sector by main contractors fell rapidly between 2007 and 2009 from £18 billion to £7 billion respectively. Although there has been a slight recovery, the total value of new orders for housing in 2011 (both public and private) was £13 billion, 39% below the 2007 level.[20]

Value of new orders for housing construction, 1997-2011
£billion, 2011 prices



Further information on Government house-building policy is set out in the Library Standard Note, *Stimulating Housing Supply – Government Initiatives.*

Split between public and private investment

Most infrastructure investment is carried out by the private, rather than the public sector. In 2011, 69% of the value of new orders for infrastructure construction was private sector construction. In 2010, the proportion was higher, at 75%. House-building has also been dominated by the private sector. In 2011, 80% of the value of new orders in the construction industry was accounted for by the private sector. The *National Infrastructure Plan 2011*

[20] Sources: ONS, *Value of New Orders in the Construction Industry*, Table 5; HMT, GDP Deflator as accessed 7 September 2012

notes that two thirds of investment in the pipeline is expected to come from the private sector.[21]

3 Barriers to private sector investment

3.1 Access to finance

According to the Government, the supply of finance was not generally a problem for private investors in the past:

> Availability of finance has not been a major impediment to delivery of infrastructure projects in recent years, other than a brief period in 2008-09, when there was severe disruption in the global banking markets.
>
> Looking ahead, most of the currently planned investment in the pipeline is either publicly financed or is likely to be financed through corporate balance sheets. This is true for instance of most road and rail network investment, almost all the investment in the regulated utilities (such as electricity and gas transmission and distribution and fibre optic cable roll-out) and a significant proportion of investment in the electricity generation sector. There is little evidence that there is any immediate systematic financing constraint that will hold back infrastructure investment.
>
> However, over the medium term, there is a possibility that corporate balance sheets may become more constrained. For example, the Department of Energy and Climate Change noted in their White Paper on Electricity Market Reform (July 2011), that the size of the offshore wind and new nuclear pipeline (if all sites are fully built) may exceed the capacity of sponsors' balance sheets to raise finance in the time required to meet the Government's renewable energy and de-carbonisation targets.
>
> In addition, internal competition for capital within the multinational companies that are key players in the UK infrastructure market is likely to increase. There is also likely to be greater competition for overseas institutional investment.[22]

However, there is now evidence of three main barriers currently holding back private sector investment: weak demand, tight credit conditions and heightened uncertainty about the economic outlook, especially in the Eurozone. There are links between these factors: uncertainty about the Eurozone is likely to reduce demand as will tight credit conditions. Some argue that an additional issue is the volume of cash reserves currently being maintained by companies which they could use to fund infrastructure projects.

Some argue that the private sector will always tend to under-invest in infrastructure:

> There are many investment projects in the British economy that could and should be pursued, but in almost all cases these are left to the private sector to work out whether net present values are positive and make it profitable to finance them. Infrastructure is different in rather complex ways, many of them mutually reinforcing. There are multiple market failures, which together are sufficient to conclude that the private sector, left to its own devices, will produce a seriously sub-optimal level of provision.[23]

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[21] HM Treasury, *National Infrastructure Plan 2011*, November 2011, para 5.24

[22] HM Treasury, *National Infrastructure Plan 2011*, November 2011, paras 5.10 to 5.13

[23] Dieter Helm, James Wadlow and Ben Caldecott, *Delivering a 21st Century Infrastructure for Britain,* 2009, p19

However, in a speech to the Institute of Directors in May 2012, the Prime Minister said that he had "asked the Treasury to examine what more we can do to boost credit for business, housing and infrastructure".[24]

3.2 Pension fund investment

Pension funds might be considered to be natural investors in infrastructure projects as they often look for long-term, stable, investment opportunities that give a stream of income. As a recent OECD report noted:

> Infrastructure investments are attractive to institutional investors such as pension funds as they can assist with liability driven investments and provide duration hedging. Infrastructure projects are long term investments that could match the long duration of pension liabilities. In addition infrastructure assets linked to inflation could hedge pension funds' liability sensitivity to inflation.
>
> Pension funds are increasingly looking at infrastructure to diversify their portfolios, due to the low correlation of infrastructure with traditional asset classes. Since listed infrastructure tends to move in line with broader market trends, it is a common held view that investing in unlisted infrastructure although illiquid, can be beneficial to ensure proper diversification. In principle the long-term investment horizon of pension funds and other institutional investors should make them natural investors in less liquid, long-term assets such as infrastructure.
>
> Despite these reasons for increased interest, so far institutional investment in infrastructure has been quite limited overall. It has been estimated that less than 1% of pension funds worldwide are invested in infrastructure projects, excluding indirect investment in infrastructure via the equity of listed utility companies and infrastructure companies.[25]

The CBI has likewise noted that:

> The long-term nature of pension liabilities mean that infrastructure as an asset can be very attractive for them. With most defined benefits schemes now close to new members and increasingly to new accrual, pension trustees are moving towards more stable liability-matching investment strategies, with a strong emphasis on long-term risk management. The long-term stable returns infrastructure offers represents a marriage of interests which is hard to ignore.[26]

However, the risks associated with the type of infrastructure development needed are higher than investors might be comfortable with. This is considered especially to be the case in the energy sector where new technologies are being developed associated with the transition to a low-carbon economy.[27] In addition, few institutional investors have the capacity to assess investment opportunities in individual infrastructure projects. Private investors have generally preferred to invest at the "brownfield" post-construction stage of infrastructure development rather than the "greenfield" pre-construction phase.[28]

The *National Infrastructure Plan 2011* stated that historically, institutional investors and pension funds had tended not to play a major role as direct investors in infrastructure assets for a number of reasons including:

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[24] No 10, *Prime Minister: A speech on the economy*, 17 May 2012
[25] OECD, *Pension Fund Investment in Infrastructure: A Survey,* September 2011, p16
[26] CBI, *An offer they shouldn't refuse: Attracting investment to UK infrastructure,* May 2012, p16
[27] HM Treasury, *National Infrastructure Plan 2011*, November 2011, p7
[28] CBI, *An offer they shouldn't refuse: Attracting investment to UK infrastructure,* May 2012

- limited capacity to assess project risks and make direct investments, as a result of which most pension funds tend to invest in infrastructure indirectly through intermediaries such as infrastructure funds, or by buying shares or bonds of publicly listed utilities;
- the lack of a clear benchmark for measuring the investment performance of infrastructure assets; and
- a shift in the future infrastructure pipeline to assets, such as the infrastructure associated with a low carbon economy, that lie outside the risk appetite of many institutional investors.[29]

4 Government policy

The Government is unlikely, in the current economic climate, to directly fund much of the needed infrastructure investment itself. Institutional investors are therefore being courted as a supply of funds. As the CBI has noted:

> Although the public and business case for investment infrastructure is clear, the government's commitment to austerity means that the public sector cannot afford to invest enough to ensure that crucial infrastructure is delivered. So the private sector must step in.[30]

Infrastructure UK (IUK) was formed as a unit within the Treasury at the time of the June 2010 Budget.[31] Its remit is to provide a "stronger focus on the UK's long-term infrastructure priorities and meet the challenge of facilitating significant private sector investment". IUK states that "some £200 billion of investment is planned over the next five years".[32] This is across infrastructure sectors such as energy, transport, waste, flood, science, water and telecoms. However, they have stated that the majority of funding will have to come from the private sector.[33]

The Government published its first *National Infrastructure Plan* in October 2010. This set out its "vision" for major infrastructure investment in the UK over the following five years. As well as emphasising the importance of stability and long-term planning for private investors, the *National Infrastructure Plan* also discussed the possibility of raising finance from private investors.[34]

The Government's second *National Infrastructure Plan* was published alongside the *Autumn Statement 2011*. It identified over £250 billion of investment in infrastructure investment, planned to 2015 and beyond. This is an increase over the £113 billion invested in the period from 2005-10.[35] Of the "pipeline" of over 500 projects and programmes identified, 40 were considered to be of national significance and critical for growth. Two thirds of investment in the pipeline would come from the private sector but the Government would consider using guarantees to support specific projects.[36]

In the *Autumn Statement 2011*, the Government announced that it would provide £6.3 billion of additional infrastructure spending over the spending review period (to 2014/15).

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[29] HM Treasury, *National Infrastructure Plan 2011*, November 2011, para 5.15
[30] CBI, *An offer they shouldn't refuse: Attracting investment to UK infrastructure*, May 2012
[31] See Infrastructure UK pages on the HM Treasury website
[32] Infrastructure UK
[33] *ibid.*
[34] HM Treasury, *National Infrastructure Plan*, October 2010, paras 3.13-3.14
[35] HM Treasury, *National Infrastructure Plan 2011*, November 2011, para 1.8
[36] *ibid.*, p6

Additionally, they announced £1 billion would be spent on new private sector investments in the regulated industries through Government guarantees.[37]

4.1 Pension and insurance fund investment

The *National Infrastructure Plan 2011* had announced that the Government had signed a Memorandum of Understanding with the National Association of Pension Funds (NAPF) and the Pension Protection Fund (PPF) to support additional pension fund investment in the UK. In addition, it stated that the Government would work with the Association of British Insurers "to set up an Insurers Infrastructure Invest Forum". Combined, these two initiatives have been estimated to "target up to £20 billion of investment". [38]

The *Infrastructure delivery update* published alongside the *2012 Budget* stated that the Government had supported the establishment of a new "Pension Infrastructure Platform" (PIP) which would make "the first wave of its initial £2 billion investment in UK infrastructure by early 2013". In addition, a separate group of pension fund investors had presented proposals to the Treasury for increasing investment in infrastructure during the construction phase.[39]

In July 2012 the NAPF indicated that the PIP could involve between 10 and 12 pension funds, investing initially £2 billion (leveraged up to £4 billion) in UK infrastructure projects.[40] In March 2012 the *Financial Times* reported Joanne Segars, NAPF chief executive, as describing the £20 billion expectation as "a long-term aspiration".[41]

In a speech to the London Stock Exchange on 10 September 2012, the Chief Secretary to the Treasury, Rt Hon Danny Alexander, confirmed that seven pension funds would be prepared to invest through the PIP:

> We have now obtained written confirmation from seven UK pension schemes to fund start up costs, and sort commitments for initial capital allocations. We expect the Platform to raise its target £2 billion by January.[42]

4.2 The UK Guarantees scheme

In July 2012, the Government announced a new "UK Guarantees Scheme" which would "dramatically accelerate major infrastructure investment and provide major support to UK exporters".[43] It would help to "start critical infrastructure projects that may have stalled because of adverse credit conditions". Up to £40 billion worth of projects that are ready or nearly ready could qualify, with the first guarantees to be awarded in autumn 2012. The *Infrastructure (Financial Assistance) Bill 2012-13* legislates to allow for such guarantees to be put in place, along with other financial support for infrastructure projects.

Eligible projects would be subject to charges, due diligence and as a minimum would have to meet five key criteria:

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[37] HM Treasury, *Autumn Statement 2011*, November 2011, CM 8231, para 2.14
[38] HM Treasury, *National Infrastructure Plan 2011*, November 2011, p7
[39] HM Treasury, *Infrastructure Delivery Update,* March 2012, para 1.6
[40] National Association of Pension Funds, *NAPF and PPF comment on Government infrastructure projects guarantee,* 18 July 2012
[41] "Infrastructure fund aiming for 2-5% above RPI", *Financial Times,* 9 March 2012
[42] HM Treasury, *Speech by Chief Secretary to the Treasury, Rt Hon Danny Alexander MP: Financing Capital Infrastructure,* 10 September 2012
[43] HM Treasury, *Government uses fiscal credibility to unveil new infrastructure investment and exports plan,* 18 July 2012

- Nationally significant, as identified in the Government's National Infrastructure Plan 2011. The Government will also consider other exceptional projects of national or economic significance on a case-by-case basis, such as university infrastructure;
- Ready to start construction within 12 months from a guarantee being given and having obtained (or about to obtain) necessary planning and other required consents;
- Financially credible, with equity finance committed and project sponsors willing to accept appropriate restructuring of the project to limit any risk to the taxpayer;
- Dependent on a guarantee to proceed and not otherwise financeable within a reasonable timeframe; and
- Good value to the taxpayer, assessed by HM Treasury to have acceptable credit quality, not present unacceptable fiscal or economic risks and to make a positive impact on economic growth.[44]

The Government noted that they would have wide discretion over how the guarantees would be structured in terms of scale, timing, risk exposure and relationship, subject to the terms and dynamics of each individual project. The guarantees could cover key project risks such as construction, performance or revenue risk. The aim would be to give investors confidence that the Government will step in if projects go wrong. The *National Infrastructure Plan 2011* stated that the Government would use guarantees:

> […] when investors cannot accommodate certain risks. The Government will, subject to affordability, consider using transparent forms of guarantee to support specific projects where this provides best value for money for taxpayers and users, recognising that the private sector cannot always bear every risk in major new projects. In line with this, the Government recently confirmed its openness in principle to provide contingent financial support for exceptional risks in the construction of the Thames Tideway tunnel.[45]

On 10 September 2012 the Chief Secretary to the Treasury stated that:

> Although it is still early days, interest from industry has been strong. In the six weeks since the launch, Treasury has had discussions with over 30 companies and project sponsors responsible for projects worth over £5bn in priority investment areas such as energy, transport, water, waste and telecommunications. Detailed discussions are already taking place with the Mersey Bridge Gateway project, considered one of the world's top 100 infrastructure projects […].[46]

Unlike Private Finance Initiative (PFI) schemes, where the private sector takes on the risks associated with large construction projects, under this scheme the Government will take on risks to allow the private sector to invest.[47] The Government has conducted a review of PFI, the results of which are expected to be published this autumn.[48] The UK Guarantees scheme does not involve expenditure, as long as the guarantees are not called in. Instead, the Government has explained that the scheme will use the Government's "hard-won fiscal

[44] HM Treasury, *Government uses fiscal credibility to unveil new infrastructure investment and exports plan,* 18 July 2012

[45] HM Treasury, *National Infrastructure Plan 2011*, November 2011, pp7-8

[46] HM Treasury, *Speech by Chief Secretary to the Treasury, Rt Hon Danny Alexander MP: Financing Capital Infrastructure,* 10 September 2012

[47] For more information see HC Library Research Paper 03/79, *The Private Finance Initiative (PFI)*, Oct 2003 and HC Library Standard Note on *Recent PFI developments.*

[48] "Pressure Builds for PFI Rethink", *Financial Times,* 26 June 2012

credibility" which will be "pass[ed] on to support the UK economy" but it is not yet clear how this will develop.[49]

4.3 Comment and reaction

Following the announcement of the UK Guarantees scheme in July 2012, the shadow Chief Secretary to the Treasury, Rachel Reeves stated that "anything which helps to get the economy moving again is welcome", but that "these proposals do not go far enough". She went on to state that there "is no guarantee that government-backed loans will see any infrastructure projects going ahead in the next year which wouldn't have happened anyway".[50]

The Shadow Secretary of State for Business, Innovation and Skills, Chuka Umunna has also been critical, stating that "major infrastructure investment projects are falling backwards. There has been delay and indecision all along the way". [51]

The CBI's May 2012 report on infrastructure investment stated that:

> The PIP [Pensions Investment Platform] is certainly part of the solution to the problems of fragmentation and lack of skills, as it both pools resources and will permit pension fund access to specialist skills.[52]

The CBI's May 2012 report argues that the PIP should not introduce a minimum investment threshold and should not restrict investments to UK infrastructure only. It then makes further recommendations on encourage the pooling of assets and suggests that the Government could "explore reinstating the dividend tax credit on a restricted basis for returns on greenfield infrastructure investment for pension funds".[53]

The *Guardian* has speculated that the fund could follow the example of Australia's Industry Funds Management:

> […] an investment vehicle whose infrastructure interests, which include Anglian Water in the UK, are worth A$10bn (£6.8bn). The PPF envisages that the fund will be a not-for-profit entity, with any surplus reinvested in further projects, although initial earnings will be used to pay off the startup capital and loans. "One thing pension funds have told us is they don't like unnecessarily costly fee structures, so we are looking to set the platform up as a not-for-profit vehicle," said Rubenstein.
>
> Another model the fund could follow is Borealis in Canada, which takes a significant stake in deals and is co-owner of a 30-year concession to operate the High Speed 1 rail line between London and the Channel Tunnel.
>
> It is understood that the NAPF and PPF have not ruled out sharing management of the fund with a leading infrastructure investor. The PPF's bullishness is in contrast to scepticism over whether the government will be able to secure the £20bn in investment it is seeking from pension funds and the insurance community. KPMG warned last week that British funds do not have the skill set to invest in infrastructure, while new

[49] HM Treasury, *Government uses fiscal credibility to unveil new infrastructure investment and exports plan,* July 2012

[50] Labour Party, *Anything that helps get the economy moving again welcome but infrastructure proposals do not go far enough*, 18 July 2012

[51] BBC News, *George Osborne in £50bn private sector building vow*, 2 September 2012

[52] CBI, *An offer they shouldn't refuse: Attracting investment to UK infrastructure,* May 2012, p17

[53] CBI, *An offer they shouldn't refuse: Attracting investment to UK infrastructure,* May 2012, p19. See also HC Library Standard Note: *Advance Corporation Tax (ACT) and pension funds.*

solvency regulations for insurers could impede putting such projects on their balance sheets.[54]

5 The Bill

The *Infrastructure (Financial Assistance) Bill 2012-13* was introduced in the House of Commons on 6 September 2012. Its Second Reading is scheduled to take place on 17 September. The legislation will come into force on the day on which it receives Royal Assent. The Bill extends to the whole of the United Kingdom.

The Bill, as introduced, is available on the parliamentary website, along with the Explanatory Notes.

5.1 The requirement for legislation

One-off expenditures incurred by Government do not typically require primary legislation, relying as they can on the authority of the Supply Procedure, and specifically the *Appropriation Act*.

However, a long-standing agreement between the Treasury and Parliament, known as the *1932 Public Accounts Committee Concordat*, or the 'Baldwin Agreement', has meant that functions of a government department that continue beyond a given year, particularly those involving financial liabilities, should be defined and delimited by specific legislation. Annex 2.1 of the Treasury's *Managing Public Money* quotes the Public Accounts Committee at the time as stating that:

> …..where it is desired that continuing functions should be exercised by a government department, particularly where such functions may involve financial liabilities extending beyond a given financial year, it is proper, subject to certain recognised exceptions, that the powers and duties to be exercised should be defined by specific statute.

In reply to the Public Accounts Committee, the Treasury Minute had stated:

> …while …the Executive Government must continue to be allowed a certain measure of discretion in asking Parliament to exercise a power which undoubtedly belongs to it, they agree that practice should normally accord with the view expressed by the Committee that, where it is desired that continuing functions should be exercised by a government department (particularly where such functions involved financial liabilities extending beyond a given year) it is proper that the powers and duties to be exercised should be defined by a specific statute. The Treasury will, for their part, continue to aim at the observance of this principle.

In effect, a department committing to a new service or function that involves significant and continuing expenditure should, as a matter of constitutional propriety, ensure specific legislation has been passed, and provision made for, the spending to be included in the Estimates presented to Parliament. Further information on the Baldwin Agreement is set out in Annex 2.1 of *Managing Public Money.*[55]

The *Infrastructure (Financial Assistance) Bill* allows for the possibility of large-scale public expenditure and the provision of ongoing financial assistance from the point of Royal Assent. It would therefore seem to meet the requirements for legislation under the 'Baldwin Agreement'.

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54 "Pension funds' infrastructure plan", *The Guardian,* 5 March 2012

55 HM Treasury, *Managing Public Money*, Annex 2.1, 14 May 2012

There is no sunset clause in the Bill. The Explanatory Notes state that:

> […] it may become clear that providing this financial assistance offers a more efficient way to support the development of some infrastructure in the medium and long term particularly in light of possible permanent changes in the structure of markets that previously provided private finance to infrastructure projects. In this case the Government would consider continuing the financial assistance to support future infrastructure developments.[56]

Fast-track procedure

The Explanatory Notes to the Bill indicate stated the Government intended to ask Parliament "to expedite the parliamentary progress of this Bill".[57] The Business Statement from 6 September indicated that only the Second Reading would take place on 17 September.[58] The Programme Motion tabled subsequently indicated that the Bill would not be fast-tracked, but would be committed to a Committee of the whole House with the Committee Stage and Third Reading to be taken on the same day.

In the Explanatory Notes the Government set out why it had considered the fast-track procedure was necessary for this Bill:

> The Government understand that there are currently commercially and economically viable infrastructure projects that are stalled because they cannot secure private finance. The timing of the UK's proposed financial assistance is currently unclear, but the evidence indicates that there are projects that might be waiting only for finance before they can proceed to the construction phase. Accordingly, it is necessary to fast-track the Bill so that the Government can provide financial assistance to projects, which are ready to proceed to construction, as quickly as possible and in order to provide confidence to the markets that the Government will be in a position to do so.[59]

Further about fast-track bills is available in the Library Standard Note, *Fast-track legislation*.[60]

5.2 Impact of the Bill on the public finances

According to the Explanatory Notes to the Bill, the impact on the public finances is an 'unknown' and depends "on the nature of the financial assistance granted, the effect on the fiscal position may be to increase the UK's level of net debt [...]".

There has been some comment about how guarantees of this kind might be accounted for in the national accounts. Nick Prior, Deloitte's infrastructure head, has been quoted in the *Telegraph* as stating that:

> This is going to be highly challenging. They [pension funds and private investors] want low risk, stable assets - not taking on the major project risk through the build phase. But if you underwrite that risk, it becomes a contingent liability for the Government and an issue for the national debt.[61]

The Bill does not exclude the option that the £50 billion expenditure and liabilities limit on funding "in relation to giving, or in connection with giving, financial assistance to infrastructure" will not be used to directly fund infrastructure projects. In this case the impact

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56 *Infrastructure (Financial Assistance) Bill – Explanatory Notes*, para 11
57 *Infrastructure (Financial Assistance) Bill Explanatory Notes,* para 6
58 HC Deb 6 Sep 2012 c383
59 *Infrastructure (Financial Assistance) Bill – Explanatory Notes*, para 7
60 HC Library Standard Note, *Fast-track legislation*
61 As quoted in "Bond financing to boost infrastructure", *Daily Telegraph,* 28 November 2011

of the Bill could be to increase public borrowing and the National Debt by the full £50 billion (this is around 5% of the current National Debt).[62] Alternatively, if the £50 billion (or part thereof) is used solely in terms of guarantees and loans, income from fees and interest may have a positive impact on public borrowing.

5.3 Clause 1: Expenditure on financial assistance for the provision of infrastructure

Clause 1 provides for expenditure on financial assistance "incurred by the Treasury or, with the Treasury's consent, the Secretary of State"[63] for the provision of infrastructure to be provided by Parliament expenditure:

> (1) *There may be paid out of money provided by Parliament expenditure incurred—*
>
> (a) *by the Treasury, or*
>
> (b) *by the Secretary of State with the consent of the Treasury,*
>
> *in giving, or in connection with giving, financial assistance to any person in respect of the provision of infrastructure.*

The Bill, as it stands, does not define which Secretary of State needs the consent of the Treasury in respect to "infrastructure assistance".

Clause 1(2) to 1(4) define "infrastructure", "provision" and "financial assistance" for the purposes of this legislation. **Clause 1(2)** defines "infrastructure" in terms of the Bill beyond the traditional definition of infrastructure (utilities, transport and public buildings) to include:

> (a) water, electricity, gas, telecommunications, sewerage or other services,
>
> (b) railway facilities (including rolling stock), roads or other transport facilities,
>
> (c) health or educational facilities,
>
> (d) court or prison facilities, and
>
> (e) housing.

The inclusion of "housing" in the definition of "infrastructure" reflects the importance of this sector to the construction sector (see Section 2.4 of this Paper).

Clause 1(3) defines the "provision" of infrastructure in terms of the Bill and extends the definition of traditional infrastructure (construction projects – see Section 2.1) to the "acquisition, design, construction, conversion, improvement, operation and repair" of infrastructure. This is similar to the range of provisions defined under Private Finance Initiative (PFI) infrastructure contracts.[64] The flexibility in the definition of "infrastructure" also allows for 'new' infrastructure types not currently envisioned – under a definition of infrastructure used 30 years ago, broadband communications would not have been classified as infrastructure. The Bill's broader definition rectifies this. **Clause 1(4)** simply allows any type of "financial assistance" to be utilised by government.

Clause 1(2) to 1(4) of the Bill do not exclude any project, part of a project, or method of funding such projects from the provision of financial assistance if it is subsequently defined by the Treasury as an "infrastructure" project. In essence, these 'partial' definitions mean that

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[62] ONS, *Public Sector Finances July 2012*, 21 August 2012

[63] *Infrastructure (Financial Assistance) Bill – Explanatory Notes*, para 17

[64] See: HC Library Research Paper 03/79, The Private Finance Initiative (PFI), October 2003 and HC Library Standard Note, Recent PFI Developments

any project, or part of a project, can be funded in any way by the Treasury under this legislation should it wish to do so.

Clause 1(5) provides that when expenditure is required under the Act and it is not possible that arrangements can be made "for the expenditure to be paid out of money provided by Parliament, for example because of timing imperatives imposed by the terms of the agreement"[65] then payment may be made from the Consolidated Fund:

> (5) *Expenditure which could be paid out of money provided by Parliament under subsection (1) is to be charged on and paid out of the Consolidated Fund if—*
>
> (a) *the expenditure is incurred under an agreement entered into by the Treasury or the Secretary of State, and*
>
> (b) *the Treasury are satisfied that arrangements cannot reasonably be made for the expenditure to be paid out of money provided by Parliament.*

Clause 1(6) requires that when payments are made from the Consolidated Fund under this legislation then the value of the amounts paid will be reported to Parliament. The Explanatory Notes to the Bill suggest that **Clause 1(7) and 1(8)** "make clear"[66] that the amount of expenditure and liabilities set out in Clause 2 and the reporting to Parliament restrictions in Clause 3 apply only to infrastructure assistance made solely under this Bill and not to other government expenditure on infrastructure finance through existing legislation.

5.4 Clause 2: Limit on expenditure and liabilities

Clause 2 sets the maximum expenditure or liabilities incurred in "infrastructure assistance" at £50 billion:

> (1) *The amount of the Government's expenditure and liabilities under this Act must not at any time exceed £50,000 million.*

Clause 2(2) defines government expenditure and liabilities for the purposes of the limit as government expenditure and contingent liabilities on "infrastructure assistance" less any income received by government from infrastructure assistance (such as fees, expenses and loan repayments). **Clause 2(3)** provides for the expenditure, contingent liabilities and income received under Clause 2(2), when this is in a foreign currency, to be valued at an exchange rate determined by the Treasury.

Clause 2(4) and 2(5) allow the Treasury to increase the limit on expenditure and liabilities through secondary legislation. Any increase in this amount would require the approval of the House by affirmative procedure. This is similar in nature to previous legislation such as the *Industrial Development Act 1982* where the total level of financial support to industry allowed under Section 8 of the Act (as amended by the *Industry and Exports (Financial Support) Act 2009*)[67] is limited to £12 billion. The current Bill unlike the *Industrial Development Act 1982* restricts the amount the limit can be increased by secondary legislation: "but the Secretary of State may, on not more than four occasions, by order made with the consent of the Treasury increase or further increase that limit by a sum specified in the order, being a sum not exceeding £1,000 million" before primary legislation is required.

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[65] *Infrastructure (Financial Assistance) Bill – Explanatory Notes*, para 17

[66] *ibid.*

[67] See: HC Library Research Paper 09/22, Industry and Exports (Financial Support) Bill, March 2009

5.5 Clause 3: Reports

Clause 3 provides for the Treasury's duty of reporting to Parliament in relation to the legislation at the end of each financial year starting on 31 March 2013. **Clause 2(3)** provides that each report will include, as a minimum:

- the arrangements entered into;
- the expenditure incurred;
- the amount of contingent liabilities and the income received during each reporting period; and
- the total outstanding amount of government expenditure and liabilities at the end of the period.

Clause 2(4) provides for first report (for the period ending 31 March 2013) to include any arrangements entered into by the Government in the period before the Act comes into force (specifically Section 1 of the Act - Clause 1 of the Bill).

Clause 2(5) allows that if there is "nothing to record" in a relevant period then no report will be made to Parliament for that period. However, it does not allow for Parliament to be informed that a report will not be forthcoming.

Clause 4 provides for the short title, commencement and extent of the Act.

6 Further information

Relevant House of Commons Library papers:

- Standard Note SN/EP/1432, *Construction Industry;*
- Standard Note SN/SP/6216, *Stimulating Housing Supply – Government Initiatives*.

Other relevant reports:

- OECD, *Pension Fund Investment in Infrastructure: A Survey,* September 2011
- CBI, *An offer they shouldn't refuse: Attracting investment to UK infrastructure,* May 2012
- Dieter Helm, James Wardlaw and Ben Caldecott, *Delivering a 21st Century Infrastructure for Britain*, Policy Exchange, 2009