



HOUSE OF LORDS

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Inquiry on

THE ECONOMIC CASE FOR HS2

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Questions 49 - 62

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3.10 pm

Witness: Professor Henry Overman

Members present

Lord Hollick (Chairman)
Baroness Blackstone
Lord Carrington of Fulham
Lord Lawson of Blaby
Lord May of Oxford
Lord McFall of Alcluith
Lord Monks
Lord Rowe-Beedoe
Lord Shipley
Lord Smith of Clifton

Examination of Witness

Professor Henry Overman, Professor of Economic Geography, LSE

Q49 The Chairman: Professor Overman, I welcome you to this meeting of the Economic Affairs Committee. This is the third session of our inquiry into the economic case for High Speed 2. We are being broadcast, so it would be most helpful if you could speak loudly and clearly. Perhaps I could start by asking you a general question: if you take the wider economic impacts out of the calculation, which have been added in for the benefit-cost ratio, would this still represent medium value for money? As a subsidiary question, do you think it is appropriate that those wider benefits should be added? If so, are all the costs that would be incurred to provide those wider benefits also included?

Professor Overman: Let me try to unpick that for you. The analysis that we have that does the cost-benefit analysis gives us two main numbers: one is the cost-benefit ratio that excludes the wider economic impacts that come from improving accessibility and the other is the cost-benefit ratio including those. The strategic case reported the cost-benefit ratio for the Y network with the wider economic benefits in of 2.3 and without about 1.7, 1.8.

Last time I was in front of the Treasury Select Committee I was asked how this related to DfT guidance on whether you say something is medium/high value for money. My understanding at the time was that if you looked at the guidance on this you should be talking about value for money without the wider economic benefits in, and that gave some cut-off points. If you did that, something at 1.8 would give you medium value for money; something at 2.3 with WEBS, wider economic benefits, if you added them in, would give you 2.3. The current DfT guidance on this is a little bit confusing about whether or not you should present them with or without these things in. The best way of thinking about it is that it is somewhere on the medium to high boundary.

The interesting thing is that the sense in which this is informative is hard to understand because 1.8 being classed as medium is not a high cost-benefit ratio relative to other

transport projects that DfT has on the books. The way I like to think about it is that if you take the 1.8, 2.3, and use the DfT terminology, it is somewhere on the medium/high boundary. It is just that I find it surprising that we refer to projects as medium value for money when they are probably in the bottom 10%, say, of transport projects that we have on the books as doable. For the purposes of understanding the debate on this, thinking about it in those terms is much more meaningful.

You asked a question on the cost side about whether or not this includes all of the costs that we might need to meet. My view, along with other experts, is that to a first-order approximation it does, so that the 1.8 without and the 2.3 with wider economic benefits are reasonably good central estimates of the benefit-cost ratio of the project.

The Chairman: In a sense, what you are saying is that the labelling is slightly misleading because this would be in the bottom decile of returns for transport projects. We are going to come on to those other transport projects later, but if you took it over the last 10 or 20 years, would that be its positioning in the league table?

Professor Overman: My basis for that comment is the Eddington report, where I was one of the advisers, in 2006 I believe, where they calculated the cost-benefit ratios with wider economic benefits of a range of projects—interurban, intraurban and something to do with connectivity to ports or something like this. If you looked at the interurban schemes that they had on the books at the time, a number of 2.3 would be somewhere in something like the bottom 20%. If you took all the schemes, the intraurban and the interurban, it would look like it was somewhere in the bottom 10%.

The Chairman: In written evidence Professor Mackie said that, “Over 99% of the Department for Transport’s investment schemes yield high or very high value for money”.

Professor Overman: My understanding would be consistent with Professor Mackie's written evidence.

Q50 Lord Lawson of Blaby: I would like to pursue the issue of wider economic benefits, which are spoken about a great deal by Ministers. They are spoken about usually in terms of creating an economic powerhouse in the north of England. We have now had the Government saying that they are enthusiastically in favour of HS3, which is a rather expensive way of connecting the major cities of the north-west and the north-east, to do exactly the same thing.

Do you think that there is a risk of double-counting? It might appear to the untutored listener that these are, to some extent, alternative ways of securing this economic benefit, and to say that you are going to get it both ways looks rather like double-counting. What is your view about that? If there is an element of that, which in your judgment is the better way to get this wider economic benefit of a northern powerhouse? Is it the HS2 or is it the trans-Pennine link, whether that is HS3 or some other form of trans-Pennine link?

Professor Overman: There are a lot of things bundled up in there. It would be fair to say that when we think about the impacts of HS3—if that is the way we want to refer to the thing that would link across the Pennines—we will need to be careful to separate out any benefits of that into those that are additional to HS2, those that are enhanced by HS2 and those that we could have had without HS2. Of course, the tricky thing is that by the time we come to rigorously start doing the analysis of that we might have started on HS2 and that then fundamentally changes the question. It depends whether you are thinking about the sequential: we have committed to HS2, now what does HS3 give us in addition to HS2? I do not know that we yet have the analysis that would spell that out. If instead you were saying,

should we do HS3 or HS2, you would approach that in a different way. The answer to it would depend crucially on what your strategic objective was for the link.

If you wanted to do something that was about rebalancing the UK, there would be a case to be made to do the HS3 link first because that delivers more of the benefits directly to Leeds and Manchester and that would then cause the rebalancing. But if you were interested in the economic performance of the UK as a whole, you might come to a completely different answer on the prioritisation of those schemes. It depends on the sequencing in which you do the assessment but also, quite importantly, the strategic objective that you are hoping that this investment is likely to achieve.

Lord Lawson of Blaby: You have told us that HS2 ranks in the bottom 10% of potential transport projects in terms of value for money or benefit-cost ratio or whatever you like to call it. Have you had time to form a view on where HS3 would rate, if you were going to do what you said a moment ago and do HS3 first before HS2? Would it be better than the bottom 10% or would it also be in the bottom 10%?

Professor Overman: I would not like to speculate on a cost-benefit basis because I am unclear about what the costs would look like for properly achieving that. My view on the benefit side—and I have said this publicly—is that I tend to think that within-city schemes in Manchester or Leeds would do the most to boost the economic activity in those two cities; let us take them as a concrete example. The between-scheme would probably be second in terms of the extent to which the benefits were concentrated on Manchester and Leeds, and then the High Speed 2 would be third in terms of how they are concentrated. But as I have consistently tried to point out in public, you want to be very careful about just looking at the benefits without looking at the costs, and the cost side of those other options has not been properly assessed.

Lord Lawson of Blaby: But should they not be properly assessed?

Professor Overman: Absolutely. One of the things that we might come to later is that I do not think the alternative options for how we would spend the money that we are going to spend on HS2 have been properly assessed.

Q51 Lord Shipley: We have had a lot of written evidence as a Committee, and a number of people have drawn our attention to your criticisms of the work that KPMG carried out on the economic benefits of HS2. Could you explain for us your objections to the report?

Professor Overman: I would like to separate out my comments here, distinguishing between the cost-benefit analysis that has been undertaken by HS2 with the wider economic benefits included, which gives us a number of 2.3 and captures some of these wider benefits. I believe that central estimate is something that has been carefully constructed.

The issue with the KPMG report is, first, they were trying to do something difficult. Secondly, they went about it in a way that involved a degree of double counting when they looked at the impact that HS2 would have. Then they proposed a solution to this double counting that was completely non-standard in the way that the literature would usually go about the problem of trying to separate out the effects of different accessibility measures on GDP.

On the issue of double counting and the non-standard separation, the headline number that has been reported, £15 billion GDP, deals with it in one way. If they deal with it in a more standard way, that halves the estimate. You have a non-standard way of dealing with the double-counting issue that gives you £15 billion. You then have a more standard way of dealing with the double-counting issue that gives you £8 billion. I find that worrying. Of course, the headline number has been picked up as the one that is now out there in most people's heads.

The second issue is that in addition to that double counting, when you look at the relationship between output per person and accessibility, you want to worry that some of this relationship is going to be driven by the fact that the highest skilled people tend to be in the places that are most accessible. Some of the impact of accessibility has nothing to do with accessibility; it is to do with the fact that we get large concentrations of high-skilled people in the places that have better accessibility measures.

For reasons that I do not understand, I think to do with the quality of the data, when KPMG corrected for that—the fact that high-skilled people tend to be in the most accessible places and so some of the relationship between accessibility and output would be driven by that concentration of high-skilled workers—it made no difference to the estimates. In comparison, work that we had done for the Northern Way, trying to answer a different question about the impact of accessibility on wages, suggested that when you controlled for the fact that the most skilled people tended to be in the places with the largest amount of accessibility, your estimate of the impact of accessibility moved a lot. It would move anywhere between 4 and 6 in terms of magnitude—reduced by a factor of 4 to 6. Again, I find that worrying.

We have a double-counting issue that gives us a £15 billion number and if we do a more standard approach we get an £8 billion number, which is half. In addition to that, other attempts to get at this relationship between accessibility and output—and not just my work, I should say—when they control for skills, see that relationship reduce a lot further. If you want a concrete example of this, London has very many skilled workers; it also has very good accessibility. If you want to understand the effect of accessibility, you have to do something to get rid of the fact that it also has a large number of skilled workers. For some reason, when KPMG do that, their estimates do not move at all, and I find that deeply puzzling.

Q52 Lord Shipley: Can I pursue the KPMG analysis? Last week Lewis Atter from KPMG told us that they have run their analysis again, substituting their way of measuring connectivity and productivity for the way advocated by the Spatial Economics Research Centre. He said that this rerun analysis arrived at the same £15 billion figure. Does this sound plausible?

Professor Overman: Let me unbundle it. One of the things in the KPMG report that I did agree with was that you could not directly compare their estimate to our estimate. There is a variety of reasons for that. The first is that we were looking at wages not output, and those two things differ; the second is that they were measuring accessibility in a different way to us, for reasons that are too technical to go into; and the third is that we were estimating them off different data. When KPMG and HS2 were looking at this, they had our measure of the impact on wages available to them and they did not think that it was the number that they needed to give the effect that they were interested in, which was the effect on GDP.

There are a number of questions about the subsequent analysis that Lewis has done and which was made available to me on Friday, the first of which is that I can only repeat that I do not see how our estimate of the effect on wages gives you an indication of what the effect on output should be. These two numbers could just clearly differ. The second problem is that it is fine to say that you have adjusted the accessibility formula to look more like the one that we did, but if you are calculating this on different data with different generalised transport costs and a different spread of activity across places, then when you calculate the changes in accessibility that feed into your estimate of what the wage impact would be, you do not know whether you are getting estimates of accessibility that are comparable to the estimates of accessibility that we were using.

To give you a concrete example of where this gets puzzling, when we were using these accessibility measures to look at the impact of a 20-minute reduction in transport times

between Manchester and Leeds, our highest percentage change in accessibility was 10% for Manchester, and it went down from there. We only looked at the 20-odd local authorities involved, but a 20-minute travel reduction between Manchester and Leeds involved an accessibility reduction of 10% maximum and about 5% on average. If you look at the analysis that has been done for HS2, for reasons that I just do not understand, KPMG are telling us that the average impact across Britain as a whole is 10%.

Without really understanding where those differences in the magnitudes of the estimated effect of accessibility have come from, I find it hard to compare these two numbers and the estimate that would come out from them. Using wage as the proxy for output, I do not understand how that works. It worries me a lot that the average accessibility effect across the whole of the UK for HS2 is modelled in a way that looks as large as the specific impact on Manchester local authority that we used for a 20-minute reduction time between these two things. It is deeply puzzling to me. Fine, if they give the same number they give the same number, but I do not understand in what sense they were doing this.

The final thing I will say on this is that in some ways it is a moot point, because for the analysis that we were doing for the Northern Way we were set the exam question that said, "If you did not care about the rest of the UK, if you were not going for additionality, if you just wanted to understand the impact on Manchester and Leeds, would the GDP impact on Manchester and Leeds look larger than the estimate you would get if you were looking at the net impact on the whole of the UK?" Of course, the answer to that is yes. If you do a scheme like reducing the travel time between Manchester and Leeds and you then go and say, "That attracts staff from across the UK, we get investment, some of it comes from other places; what does the impact of that look like?" you get an answer that is larger than if you

are saying: how much of that is additional for the UK as a whole? KPMG have taken that conceptual approach and applied it to the UK as a whole.

Whether this number is £15 billion or £8 billion or £3 billion, it is not an additional number. Presenting that as the additional impact for the UK in any way that is meaningful seems really odd to me, whereas in contrast when we were working for the Northern Way you had an objective to try to drive the growth of the north. The exam question, “If we were not too worried about the benefit to the UK economy as a whole, what would the GDP uplift look like in Leeds and Manchester?” seems to me to be a perfectly acceptable question to ask and to try to get that through this route.

So there is a puzzle about why these numbers come out the same, although my initial criticism with the double counting and the inability to control for skill still applies to the KPMG number. It is also just stepping back from it and saying, “What are we learning from this?” I am not sure in what way this approach is meaningful in terms of figuring out the extra benefit that this project gives. We have an estimate of that in the wider economic benefits; it is about £0.5 billion a year.

Q53 Lord Carrington of Fulham: My question carries on from that to some extent. It brings it back down to what the politicians keep talking about, which is the shortening of the time spent getting from London to Birmingham for HS2. They talk about that as being a major benefit and I am not quite clear in my own mind as to how shortening the travel time between London and Birmingham produces economic benefits. Do you have a simplistic view of that?

Professor Overman: I do. There are reasons to think that it would deliver some economic benefits, and I would probably identify three. It helps business if they are able to employ workers across a wide, large labour market. The fact that business in London is able to

recruit people from a large labour market because it has good transport links clearly benefits London currently. It will help firms in Birmingham or Manchester or Leeds if they are able to pull from a larger labour market than they have perhaps done hitherto. That is one way in which it will help.

The second way is that in the production of business services, broadly defined, there are lots of inputs that maybe require you to get together and meet with people, for example lawyers going to meet with clients or an advertising agency going to meet with people who want to understand the impact of their advertising or anything like this. Again, if you have specialised services, say in London, then allowing a firm in Manchester to more easily access those specialised legal services or financial services or accounting services will be beneficial to business. Flipping that round on the other side, if you are a legal firm, for example, you care about how hard it is to get to your customers and being able to travel more quickly to get to your customers benefits you in terms of the markets that you can serve.

So there are good reasons to think that being able to travel quickly between places will to some extent improve the functioning of the labour market, will to some extent help firms—particularly the service sector here, given that we are talking about High Speed 2—produce their outputs and also sell their outputs to the market.

Lord Carrington of Fulham: I can understand about reducing the travel time in the way you have described it, but it is not the travel time on HS2, is it? It is the door-to-door travel time that is important. If the HS2 station is in a green-field site somewhere outside the city centre and you are a company based in the city centre, extra time to get to the HS2 site might negate the benefits of the extra speed on HS2.

Professor Overman: That is a fair point. People have very strong views on this. I have not looked too much at the discussion around the exact placement of the stations, city centre

versus edge. My view on this is that ideally to maximise the benefits of this—the effects that I have just talked about, labour markets, inputs, selling to markets—you would want the stations in the middle of the city. Of course, that increases the cost. There is a tricky trade-off there.

Probably, on balance, one should not go too far on this and in a little way this comes back to the thing we were saying about the WEBs earlier. You asked me whether I thought that WEBs were a reasonable estimate of the wider benefits that came from this, and I do. They are calculated on the basis of a reduction in journey time. The exact placing of the stations within a local authority or a city will impact that somewhat, but I do not think that it is majorly leading us astray. When you come to specific stations, there is a very difficult trade-off. My view is that wherever possible you would want to think about putting them in the city centre to maximise the benefits of them, but I realise there is a cost implication.

Lord Carrington of Fulham: There is some evidence from the French example that where the stations have been in the city centre on the TGV it has had a positive economic benefit but where the station has been outside, it has had very little or possibly even a negative benefit. I am thinking particularly of Lille and Avignon, two classic examples that have been quoted to us.

Professor Overman: The trouble is that it is difficult with international comparatives. Probably the way to look at it is that we should try to have them in the city centres to maximise benefits. If we decided that the cost implications of that are too large so that in some places we are going to go on the edge, then I think that the way around is to ask ourselves: how are we going to go about maximising the benefits of the stations on the edge? Where we would clearly get ourselves in trouble is if we put stuff on the edge of towns and then it is in the green belt or there are constraints on development and so on, so

we do not do anything around it. That would seem to me to be something that would downplay the benefits.

I am uncomfortable with using international comparisons to say that inner city always works and edge of city always fails. I would rather do it this way, saying let us get into the centre if we can. If we really think that the cost implications of this or the route deviation effect or whatever is too large, let us think about the edge, but if we are going to go for the edge we have to think about how we maximise the benefits around it.

Q54 Lord Rowe-Beddoe: Professor Overman, to have a chance of achieving a 2.3 cost-benefit ratio, it appears that city regeneration programmes will have to be a major objective. Could you tell us what supplementary policies you think are required to realise that objective?

Professor Overman: I would be careful in reaching the conclusion that to achieve a 2.3 requires additional activity around the station. In some ways I made that clear when I said I did not think that we needed to do additional investments and so on to get that 2.3 wider economic benefit. The way to think about this is that the infrastructure itself is supposed to deliver the wider economic benefit, plus the travel cost savings and so on. We think that 2.3 is our best estimate of what that will do, and then we will do other things around this in an attempt to increase the return that we are getting on the investment that we have already made. I would separate out the need to do things around the stations that necessarily deliver the 2.3 benefits. This goes back a little back to my earlier answer. If we wanted to maximise the benefit of the investment once we have done this and try to think about ways that we might get more return on this, we will need to co-ordinate carefully around the stations that we see.

It is difficult to know exactly how that co-ordination should occur. People seem to have very strong views on this and I find myself not sure which way to go. There are some people who think that we need some very top-down efforts to co-ordinate this, so we need a task force. There are others who argue very strongly and equally vociferously the exact opposite, which is, "No, Manchester is best placed to achieve the benefits of this". Personally I do not take a strong view on it. Generally I lean towards the idea that we possibly want to be a little bit less centralist in the way the country runs. Certainly Manchester, Leeds, Birmingham having a large input into how we deliver this would be an important part of the process.

Then exactly what we need to do is far trickier. One of the things that will be very difficult is that a lot of what will happen around these stations will be displacement from elsewhere within the wider city area or within the wider region, and managing that displacement will be difficult. When we come in and regenerate around the new station at Birmingham or around Manchester, a lot of the firms that are going to locate there and the things we are going to do there would be activities that would have gone elsewhere within the Manchester urban area. Managing that is always difficult.

The classic thing that will happen is that we will start using this as a focus for investment, but then people will be worrying terribly about the places that are not getting investment or losing investment as a result of this and this would be a very difficult thing to manage. The most concrete example of this that I have seen so far is the discussion around Old Oak Common. Lots of people have been talking about what would happen at Old Oak Common if we stopped HS2 there and the fact that it would allow for new commercial development and so on. If I were, say, Croydon, an area that offers lots of commercial space that might be a rival for the commercial space at Old Oak Common, I would be worrying a lot about this. So

there will be lots of tensions to manage. How exactly we go about making sure that we maximise the benefits of this is a much harder question to answer.

Lord Rowe-Beddoe: I am sure it is. Many people have suggested that the addition of the economic regeneration proposal is part and parcel of the whole case for getting somewhere faster and the proposal for spending all this money in getting networks. You rather surprised me because I would have thought that the key thing is the growth of GDP in that part of the United Kingdom that is severely behind the eight ball at the moment. Is that not where you are coming from?

Professor Overman: There are two things to separate out. When we talk about regeneration around the stations, we have to face up to the fact that lots of that will be displacement from other places in the city area. It has always caused confusion for people when you look at the impact of these things. When we get lots of shiny buildings in one part of cities, it is often because we have chosen to do a lot of spatially concentrated investments. This might be a good strategy, it might be a poor strategy, but we have to realise that lots of that regeneration comes from other parts of the urban area and think about how we are going to manage that.

Your follow-up question was subtly different: if we achieve that development around the stations, what do I think that is going to do to the relative balance of economic activity in the United Kingdom? There I think we simply do not know.

Here is what I think we can say about what the likely impact of HS2 will be in terms of the economic geography of the UK. We can be fairly confident that it is going to benefit places on the line relative to places that are off the line, and then we have no idea which stops on the line will benefit more. I do not know whether it will be the southern end, the northern end or the middle. One of those is going to benefit the most out of this. We have some

modelling on it from KPMG. Work on that is in its infancy. For what it is worth, it says that, “The absolute increase in London is larger, the percentage increase is smaller”. It is hard to say whether that is really where we would be. I think we genuinely do not know what it will do in terms of balance along the line.

Lord Rowe-Beattie: At the moment you do have industrial and technology centres throughout the United Kingdom, so one can build on that, surely. The automotive industry is an example.

Professor Overman: The extent to which HS2 rebalances the UK is a moot point and we just do not know.

Q55 Lord May of Oxford: First, I apologise for being late and, secondly, I would like to go a little bit off-piste on this. In all this machinery of calculating costs and benefits—it is not something that is in front of me, I am afraid—I am not aware of us ever taking on the issue of, given that somewhere between 500,000 and 1 million people are annually being added to the UK population by immigration, to what extent this is likely to distribute people more widely. What is the interplay between these? Could you say very briefly? Possibly the answer is that no one is looking at it.

Professor Overman: It is one of those questions that get us into the discussion about what is the project for. So far we have been talking a little bit about this as an economic project. What does it do for the GDP of the country as a whole? Which of the possible schemes out there might deliver more or less for different parts of the country? How much of this is additional? How large do we think the effects are? What would the rebalancing effect be? Those are all questions about this as an economic project.

Lord May of Oxford: As I say, it is a very narrow analysis that enables people to turn the handle on the machinery that they have, but it seems to me peculiar that it is not

complemented by asking: what are the possible unintended consequences that we do not have a machine to turn the handle on? I do not even trust the machine as it has the peculiar property that you say the cost-benefit ratio, which in most mathematical contexts would mean you wanted a small one, is turned upside down. That is an irrelevant comment but it leads to a kind of mistrust.

Professor Overman: What I was going to go on to say is that if we start to think about managing any increase in population that we might be going to see then it starts to become a question about its role as a transport project. That gets us into another separate branch of modelling efforts that have basically been saying, “We want to think about this as we have a growing population, we have a growing number of journeys being made, we are going to have congestion on the network, so how does this play out as a transport investment?” That is the general way the question is being approached.

Lord May of Oxford: Two very quick things. We have heard a strongly argued case, at least by the people who argue it, that Stoke would be a better candidate than Crewe to take advantage. We discussed that last time. Do you have a view on that?

Professor Overman: I do not have any view on Stoke versus Crewe.

Lord May of Oxford: Finally, the question I think I was meant to ask: to what extent do you believe the strategic case has been convincingly articulated as a narrative of why we need it?

Professor Overman: Ironically, my answer to your first question was sort of getting at that.

Lord May of Oxford: Yes, you could see where I was going.

Professor Overman: It is difficult. These are highly political debates that are being had. The difficulty we have with this is that it is still not completely clear what is the strategic case for the investment. It seems to me that we have ended up with the railway before the strategic case, which is something that I know Peter Mackie, for example, is keen on saying about this.

I do not know whether it is really intended as a growth investment, where we are worried about what the impact of this is on UK GDP as a whole. I do not know if it is not a growth investment but it is a rebalancing investment. Is this something that we really think is going to narrow the north-south divide and deal with rebalancing? Or is it a transport project, clear and simple, to deal with the congestion issues that we are going to face on the north-south lines as a result of growth in population, GDP growth and rising passenger numbers? I have to say at the moment it is presented as all things to all men and the answer given is, "Actually it helps with all three of these".

I think the point is that, depending on which of those you are asking about, there are other options that would possibly deliver better effects. If you think about it as £50 billion, it would be reasonable to ask whether there are other investments of that £50 billion that would have been better for UK plc if we are thinking about it as growth. If we are thinking about it as rebalancing, we could have asked different questions about how we would spend that £50 billion to achieve rebalancing. This comes back to Lord Lawson's question, for example, about whether you would do HS3 before you did HS2. If instead we were saying, "We have major congestion, particularly on the southern end of the line; what should we do about that and how might we do this?" we might again come up with a different set of answers.

At the moment one rather feels that we have the project and we are searching around for the narrative that justifies the project. Depending on which of these three crucial things you were interested in, for each of those three you might point to other alternatives. It might well be that this is the lowest common denominator type solution that gets you a little bit of all three of those things. I am perfectly open to that, but if we knew what the strategic objective was and had it clearly articulated we would be in a better position to answer questions about the opportunity cost of the £50 billion investment.

Q56 Lord Monks: Can I probe a little more on the alternatives to HS2 and your view on those? The strategic case for HS2 did compare HS2 and the phase 1 alternative with some issues like lengthening the trains, lengthening the platforms and so on. You were very critical before the Treasury Committee of not sufficient attention being paid to these things. You just started, in reply to the previous question, to talk about those things. Do you have any particular view on what would be a good alternative to this new railway? Do you have a favourite that you would like to share with us?

Professor Overman: No. It has always been my position on this that at the end of the day it is not my role to make the final decision about which of these options is better. Throughout the debate on this, I have always tried to inform decision-makers on what the evidence tells us about the different costs and benefits of these. In answer to your question, it depends a little bit on what strategic objective you are trying to achieve.

In a narrow sense, my criticism was that I felt we had not looked at the alternative uses of that £50 billion in either the broad or the narrow sense. I hinted at the broad sense just now, so let me talk about the narrow sense. The broad sense was the things I was saying, "If you wanted to achieve the growth objective how would you do it? If you wanted to achieve the rebalancing objective how would you do it?" The narrow version of this says, "If I wanted to achieve the transport objectives in terms of dealing with congestion, what would I do?"

What I felt was disappointing was that at the point where Members of Parliament were being asked to vote on it, they had basically been presented with something that said, "These other options for dealing with congestion have a wider benefit-cost ratio of 3.1, which is substantially more than 2.3 for HS2, but we are ruling them out because the disruption would be too severe". It was a red flag on a traffic light system at the back of one of the reports. I felt that if I was a Member of Parliament being asked to think about

alternatives, having someone say to me, “We have these two alternatives for dealing with congestion, one of them has a benefit-cost ratio of 2.3 for every pound you spend. Here is this other one that has a benefit-cost ratio of 3.1 but we feel this one would be far too disruptive and here is my back-of-the-envelope calculation that gives you some feeling for why that is”, is not a satisfactory position to put decision-makers in when they are asking about things.

My criticism was that what I would have liked to have seen was those disruption costs monetised so that we could get a feeling for quite how disruptive this was going to be, to compare that to the disruption that was going to come with HS2, which will involve a fairly substantial amount of disruption, and we could have presented this to policymakers. What I do not like is us basically saying, “You have two options for investment here but this one really honestly I would not do it”: I do not like that approach to doing it.

My criticism there was I felt that on occasions Ministers, MPs and decision-makers more broadly were being asked to make decisions in a situation where they were being presented with evidence about the options that was incomplete—and that was a particular example. I have never taken a view on whether the claims put forward by the other four, five, six, 10 alternative schemes about the huge benefits that we would get from those are valid. I do not have a strong view on the huge number of options that have been put out there. I have fairly strong views that the process by which decision-makers have been informed about the options has not necessarily been satisfactory.

Q57 The Chairman: You have been calling for a rigorous analysis of alternatives for about five years. Why have your words not been heeded? Secondly, is it the case that for large infrastructure projects the Department for Transport does not consider alternatives properly?

Professor Overman: I honestly do not know. I do not think that this is a problem that is unique to HS2. One of the criticisms of Eddington in 2006 was that DfT struggled with strategic option generation in a way that would allow comparison of alternative projects. Progress just does not seem to have been made on it. For the reason why that is you would probably need to ask someone who has the levers necessary to make progress on it. A number of us have made it clear that we would like to see better strategic option generation at work in DfT. This was something that Eddington said very clearly in 2006 and eight years on arguably we are not there. Could you repeat the second part of your question?

The Chairman: Is it the case that the Department for Transport does not consider alternatives when it is looking at major infrastructure projects like this?

Professor Overman: You would have to say that if HS2 is a case study of where we have got to with strategic option generation, we still have problems with that.

Baroness Blackstone: Can I just follow up? Why do you transport economists not get together and ask the ESRC to fund a big project on this? I am not sure that one should leave this sort of investigation entirely to government departments. It does seem a bit strange that here is a very interesting applied economics question and no one has sat down and addressed it and come up with some alternative answers. I am struggling, as a Member of this Committee, to understand what it is that might be better. There clearly are plenty of possibilities that might be better, but so far nobody has been able to tell us: nobody has been willing to put their head above the parapet and say, "There is this project or that project and they all require very careful political and policy consideration".

Professor Overman: I am not a transport economist. I should make that clear.

Baroness Blackstone: No.

Professor Overman: The criticism is a very valid one and it is something that I have said, which is that some of this stems from the fact that transport economists and transport appraisals traditionally have worried a lot about getting to the welfare impacts of projects—doing ex-ante cost-benefit appraisals of the benefit-cost ratio—and have not displayed anywhere near as much interest in the wider impact of this. Their response to that would be, “Yes, but these effects are not additional”. They have put all of their effort into trying to get an accurate measure of the welfare impact of transport projects. Of course, it is a frustrating discussion to have sometimes when you are saying, “Yes, but decision-makers care about other things, like what we could say about the employment impact, what we could say about the GDP impact”.

In fact, to bring you back to the example I gave earlier, when we were asked by Northern Way, “Tell us what faster journeys between Manchester and Leeds would do”, the original discussion we had with them said, “You have the wider economic impact assessment of that scheme that gives you the net additional figures”. The chief executive for the Northern Way said, “Yes, but actually, given that we care about employment and GDP, we want to know what the impact on those things would be, even if we accept that that is not additional, and not the stuff that you would put in a narrow cost-benefit analysis”. To some extent we were trying to get at those wider impacts and start to fill the gap, although the discussion that we have just had on KPMG says you have to be very careful about how far you go down that route.

One thing is that traditionally there has been lots of cost-benefit appraisal that has worried about this upstream, worried about the welfare effects, and has not thought about this. The second thing is that moving downstream and thinking about the actual impact that projects have has been something that historically has not been high on DfT’s agenda. DfT has

invested a large amount of money on ex-ante appraisal but not on ex-post evaluations: figuring out whether or not the thing really did achieve what it was meant to. The third thing is it is just very difficult.

There is lots of analysis going on. I know it is disappointing to decision-makers, but my answer is that broadly speaking we know that it will probably pull stuff on to the line and one end of the line or the other or the middle will benefit. The benefits will be distributed along the line but in ways that I cannot tell you. I hate to say it but that is an evidence-based position that comes from a large body of work. These are just very difficult questions.

Q58 Lord Smith of Clifton: You have already discounted, to a great extent, international comparisons, but can I just take you back to that? The analysis of high-speed rail projects in other countries by Albalade and Bel from the University of Barcelona concluded that political objectives for regional equality and development lead to the economic failure of high speed rail projects. How instructive do you think these comparisons with other countries are? It is also true, as Baroness Blackstone said, we do not know much about in-country comparisons.

Professor Overman: One should be careful with international comparisons; I have made that clear. Having the policy objective to re-balance across places driving your high-speed train investment can get you into a terrible mess. In defence of what we are trying to do with High Speed 2, we are not pushing the kind of projects that could get us into a terrible mess. The point about High Speed 2 is that the returns on it are not great but they are not awful. It is a sort of mediocre, medium-return type of project.

Where those kinds of things can get you into real trouble is if you are basically saying, "I have to put this out to some poor Spanish region because getting high-speed rail out to this poor Spanish region is going to do something to rebalance the economy". Then someone comes along, looks at the economic case for that and says, "My goodness, the benefit-cost ratio of

this is 0.2. For every pound we spend on this, we are only going to get 20 pence back". Then you say, "I am going to do this anyhow because I am so keen on doing rebalancing". It is that kind of situation that this would really apply to.

If you do these projects driven only by the desire to rebalance where the economic case looks awful, that can get you into terrible difficulties. We should be clear that High Speed 2 does not sit in that camp. The return on it, the benefit-cost ratio, is above 1.0. It is not a project that you are doing because you are hoping that it will bring stuff to some peripheral place. Much more useful questions are the ones that I have been trying to steer us towards: what will it do for the north-south—let us just try concretely to understand that as our objective—and also are there other better ways of spending the money? I would draw the distinction between the kind of projects where you are only doing these bridges to nowhere type things and High Speed 2. I do not think that is the situation we are in.

The benefit-cost ratio is around 1.8-2.3. You are getting benefits that are safely above the pound. All the questions are just about alternative uses of the money.

Q59 Lord Smith of Clifton: Thank you for that. Lord Monks reminded us in private session of the Doncaster paradox. It has very good communications east-west and north-south but remains relatively economically deprived. We were told by witnesses last week that once you get the high-speed thing going it is up to local authorities to take advantage of this: implication, Doncaster has not. Is there a case for looking at Doncaster and finding out why superb communications, relatively speaking, have led to very little economic improvement?

Professor Overman: I would turn it the other way round as a warning that says that accessibility is only one part of the story about success. This has almost brought us full circle to why I worry so much about the need to control for the distribution of, say, skilled workers when we are trying to figure out the impact of accessibility. We will always be able to find

places that have good accessibility. It is just a reminder that the things that drive success are not accessibility alone. They are accessibility, the decisions of skilled workers and the decisions of companies about where to locate. That is precisely why, when I think about estimating the impact of these things, I want those things carefully separated out, but they are also why I keep warning that just pointing to the fact that this will improve accessibility does not necessarily mean it will help us achieve our broader strategic objectives.

Q60 Lord Lawson of Blaby: You have spoken with great confidence about the cost-benefit or benefit-cost ratio. You have said that it is mediocre and you have also stated very confidently that there is a cost of £50 billion, which is the Government's figure. Many people have felt that the cost is likely to be very much more than that, which of course alters everything. I must say that if I was still involved with the Treasury I would be particularly concerned about the cost of this project, although it is true that because it is so far ahead you might leave it to the next generation. How robust is this cost estimate, which is the foundation for everything that you have been saying to us this afternoon?

Professor Overman: I am going to give you an answer that I suspect will not satisfy you. I have always taken the costing of the scheme as given in trying to think about the benefit-cost ratios, for the simple reason that it occupies enough of my time thinking about what the benefits might be to offset against those costs.

On a purely personal basis, I think I share your scepticism about our ability to avoid cost overruns on major projects, but I take the costs as given and I focus on the benefits side of it. While I share your scepticism on costs, I think that that is a more appropriate question for other people who will be in charge of managing them.

Lord Lawson of Blaby: It is a crucial question.

Professor Overman: I think it is absolutely crucial. I have absolutely no disagreement with you on that.

Lord Lawson of Blaby: It is a question of who we ask.

Q61 Baroness Blackstone: What is your view, as an economic geographer, about the priority you would give to creating better links between regional cities rather than improving links to London? The City Growth Commission report came out last week; they want to create more of what they call economic powerhouses in the north and the Midlands, partly through greater connectivity. Do you agree with them and what is your view about the options here?

Professor Overman: My view on this is that if the objective is that we want somewhere to rival London, it will require a big northern city, not a collection of well connected northern cities spread out across the whole of the north. It is one place—if that is the objective. The evidence that we have says that what is driving London's success is the concentration of very many high-skilled workers in a dense urban core where they commute and produce every day. You can, to some extent, replicate that by joining up these conurbations, but the evidence is very clear that the really large things come from the huge economic density that we have sitting at the heart of the conurbation.

It helps that we can get a commuter shed around this that allows people to commute in and so on, but right at the heart of it is the huge density that we have over here in terms of employment that is driving it. If you want to rival that, you need somewhere that is going to have similar economic mass. My view is that if that is the objective, concentrating resources within one of those places, in terms of transport investment and what we do in infrastructure and housing and so on, will be far more important than linking those places together and will be far more important than linking those places to London.

Interestingly, this comes a little bit back to the question about strategic decision-making. It is always interesting to ask political leaders in these places, “If we gave you the option of £7.5 billion each, what would you do with it? Would you pool it together to do Manchester-Leeds?” You are Manchester: Howard Bernstein and Richard Leese. “Here is £7.5 billion. What would you do with it?” My gut instinct is that their analysis would suggest that you do stuff within the city of Manchester. They might, at a push, be willing to pool with Leeds to speed up connections between Manchester and Leeds. I suspect that HS2 would then be next on their priority list of what they would do with the money, and then you would get this sprawling project connecting in Newcastle and Hull and Liverpool. These things would be far down their strategic prioritisation list in terms of things that they think would drive the performance, and I think that is telling. The interesting thing is if you ever asked them, “Why do you not talk about it in those terms?” they would suggest that this is not really what is on offer to them. They feel it is HS2 or nothing. Of course, if you are Manchester or Leeds, you take HS2 over nothing, because you are not going to pay for the vast bulk of the cost. It is going to come from the national taxpayer.

Looking at the evidence, I think that if you want counterbalance London, somewhere big in the north is a priority over connecting up. I think that the connecting up will help. Next after that would be connecting to London and next after that would be some sprawling network of terribly costly trains across the whole northern area. If you asked local leaders what they would do when offered the option of the money, I have a feeling their priority ranking might look rather similar to mine.

Baroness Blackstone: Do I take it from what you said that Manchester would be your option for this development of a major northern city that might begin to compete with London, at least in certain respects?

Professor Overman: I think on the basis of where we currently are, it is the one that stands the best chance.

Q62 Lord Smith of Clifton: One question we have not discussed this week, which we discussed last week, is the question of freight. We have been concentrating on passengers. Have you any comments on freight, bearing in mind that east-west, west-east freight is rather important in terms of the railway?

Professor Overman: The freight aspect of the project is something that I have not looked at in depth.

The Chairman: Professor Overman, thank you very much indeed. That was a most helpful session. You are very welcome to stay and listen to the next witnesses, who will no doubt be asked some of the questions that you have just answered. Thank you.