
DANGER

SNAPSHOT

- **Few topics provoke such varied – and passionate – reactions as the proposal to build a new high-speed rail link (HS2) between London, Birmingham and a number of Northern cities.**
- **Britain does not have adequate transport infrastructure, and decisions on the future of our infrastructure are too often left to wither in the long grass, but is it worth spending nearly £50bn on a project that, at best, will increase the productivity of just 20% of the business population?**
- **HS2 is not the infrastructure project Britain needs, nor that British business wants. Not enough businesses stand to benefit from it.**
- **From 2011 to 2013 the importance of high-speed rail to IoD members' businesses has fallen significantly.**
- **IoD members would rather see £50bn spent on bringing Britain's existing transport infrastructure into the 21st century.**

High Speed 2: on the wrong track

Andrew Silvester, Senior Parliamentary Affairs Officer at the Institute of Directors, argues that High Speed 2 is not the infrastructure project Britain needs, nor that British business wants.

There is perhaps no single topic that provokes as many varied – and passionate – reactions as the proposal to build a new high-speed rail link (HS2) between London, Birmingham and a number of Northern cities. Proponents welcome a grand British infrastructure project, Victorian in its ambition and scale. Critics pick at the business case for it.

Lord Adonis announced the plan for HS2 in March 2010, just two months before a pivotal General Election. The scheme – expected at that point to come in with a price tag of £30bn – was heralded as Britain's answer to the bullet trains of Japan, the TGV in France, and the proposed (now increasingly unlikely) high-speed link between San Francisco and Los Angeles. It was an alluring vision.

Of course, Lord Adonis's Labour Party was cast out of office in 2010, replaced by a Coalition Government that had been sceptical but broadly supportive of the scheme in opposition. After much discussion around the specifics of the route, the Coalition pledged support for HS2 in January 2012.

Since then, criticism has mounted. The estimated cost has risen from the original £30bn estimate to £46.2bn, with Boris Johnson anticipating it could hit as much as £70bn.[1] The Institute of Economic Affairs put the cost at £80bn.[2] The Prime Minister and the Transport Secretary, Patrick McLoughlin, seem in no mood to row back from this 'grand projet,' but the cross-party consensus seems to be cracking. Labour, in particular, is concerned the costs are creeping too high for the project to be justified. There remains speculation that HS2 will be notably absent from its 2015 manifesto.

To give a business-eye view of the current condition of the country's transport infrastructure, and on the controversial topic of HS2, the IoD carried out a survey of over 1,300 directors to gather their views.[3] Their thoughts on the productivity impacts of HS2, the significance of the project for regional economies, and their investment priorities are all important to consider when assessing whether the Government is right to keep high-speed rail's wheels in motion.

[1] Christopher Hope, "HS2 'will cost over £70bn', says Boris Johnson," *Daily Telegraph*, 7 July 2013.
[2] Dr Richard Wellings, Institute of Economic Affairs, *The High-Speed Gravy Train: Special Interests, Transport Policy and Government Spending*, 19 August 2013.
[3] The IoD surveyed 1,323 IoD members between 31 July and 13 August 2013 using the IoD's online *Policy Voice* panel, a community of IoD members who participate in monthly surveys on public policy issues.

"The time has come for Britain to plan seriously for high speed rail between our major cities. I believe high-speed rail has a big part to play in Britain's future. Over the next twenty to thirty years the UK will require a step-change in transport capacity and connectivity both to promote and respond to long-term economic growth… High speed rail would be by far the most effective way to achieve this step-change, offering a balance of capacity, connectivity and sustainability benefits unmatched by any other option."

Lord Adonis, then Secretary of State for Transport, 11 March 2010.

PRODUCTIVITY

One of the many arguments that HS2 proponents have put forward is that HS2 will, in speeding up transport around the country, improve the productivity of business people. There is certainly something to this argument, though HS2 Ltd (the Government's arms-length body guiding HS2) did itself few favours in originally using assumptions made before smart phones and 3G-networks existed.

"The improvements in productivity would be expected to persist in the years following the opening of HS2, and may increase as the economy grows."

KPMG, *HS2: The Regional Economic Impact,* September 2013

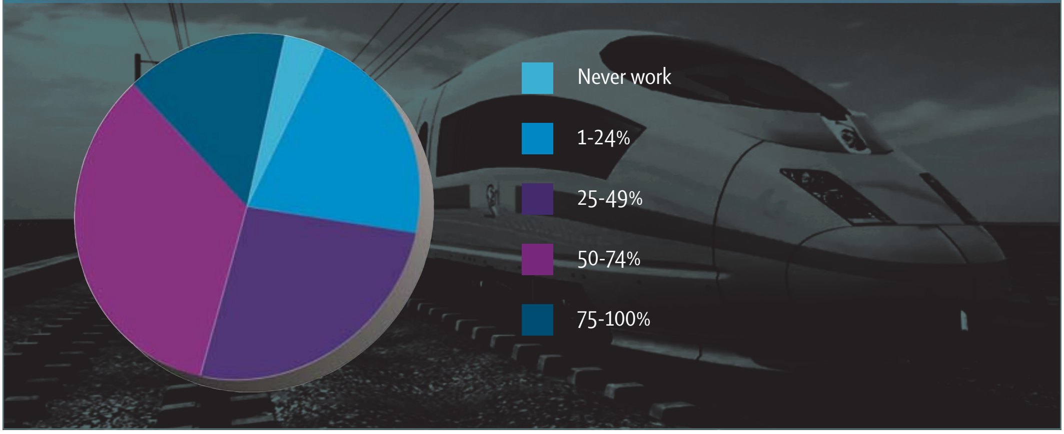
In its latest cost:benefit calculation, the Department for Transport has downgraded the "value of time" lost to a businessperson whilst in transit from £47.18 to £31.96, recognising that the original figure was not a credible one, as our survey of IoD members clearly demonstrates (Chart 1).

The productivity impacts resulting from a reduction in journey times make up some 44% of the total net benefits of the scheme, but do IoD members recognise the argument?

IoD members are sceptical, with most (70%) believing HS2 will have no impact on their overall productivity, and only 24% expecting benefits (Chart 2).

CHART 1

When taking the train for business journeys, what proportion of your time would you say that you spend working on the train?

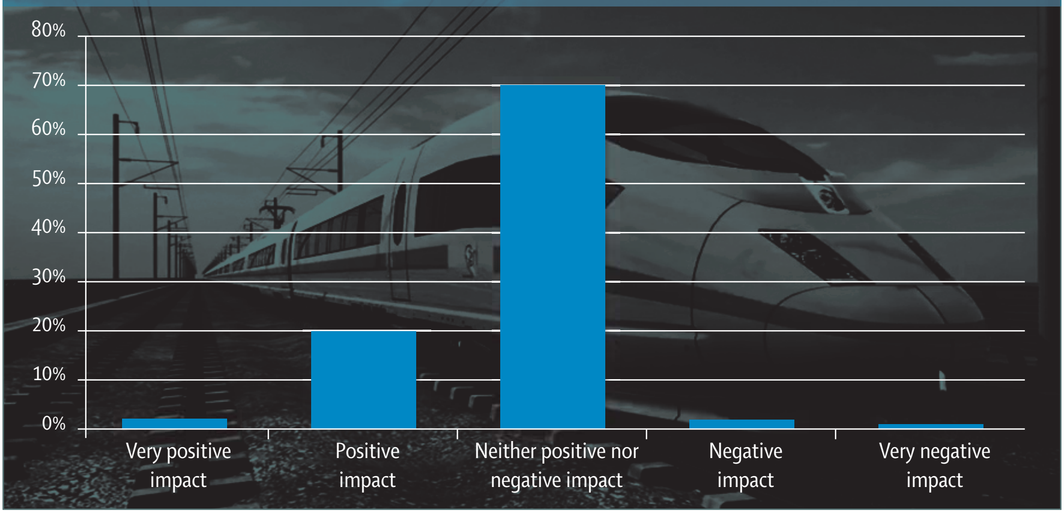


> *"The risk is that transport policy can become the pursuit of icons. Almost invariably, such projects – 'grands projets' – develop real momentum, driven by strong lobbying. The momentum can make such projects difficult – and unpopular – to stop, even when the benefit:cost equation does not stack up... The resources absorbed by such projects could often be much better used elsewhere."*

Sir Rod Eddington, *The Eddington Transport Study*, December 2006.

CHART 2

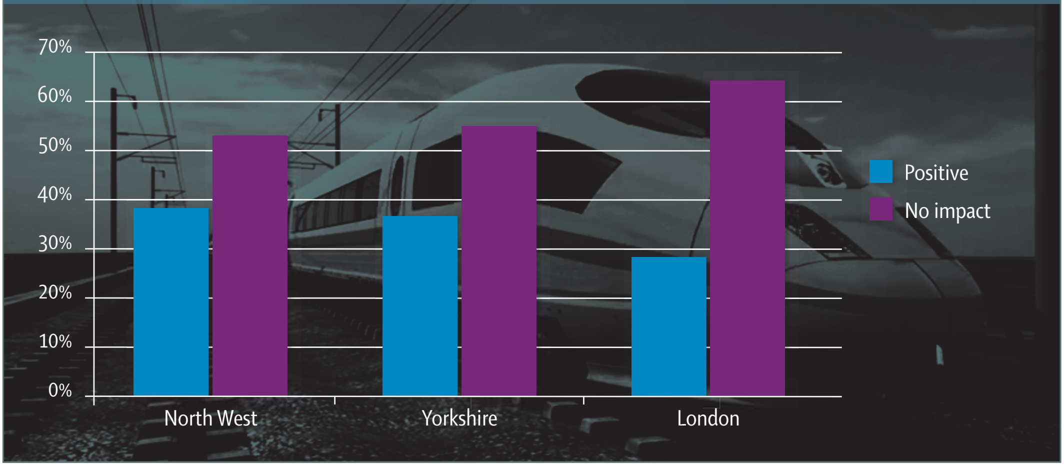
The perceived impact of HS2 on the productivity of IoD members' businesses



The regional picture varies a little, but in no region do more than two-fifths of IoD members think that HS2 would have a positive impact on their productivity. Notably, as Chart 3 shows, this includes the very areas that HS2 is expected to pass through.

CHART 3

The perceived impact of HS2 on the productivity of IoD members' businesses by region



To say the least then, IoD members are unconvinced that HS2 will deliver the kind of productivity benefits that the case for its construction in part rests upon. And this begs another question – is it worth spending nearly £50bn on a project that at best will increase the productivity of 20% of the business population?

REGIONAL GROWTH

"Economically, socially and politically, the north is becoming another country"

The Economist, "The Great Divide," 15 September 2012

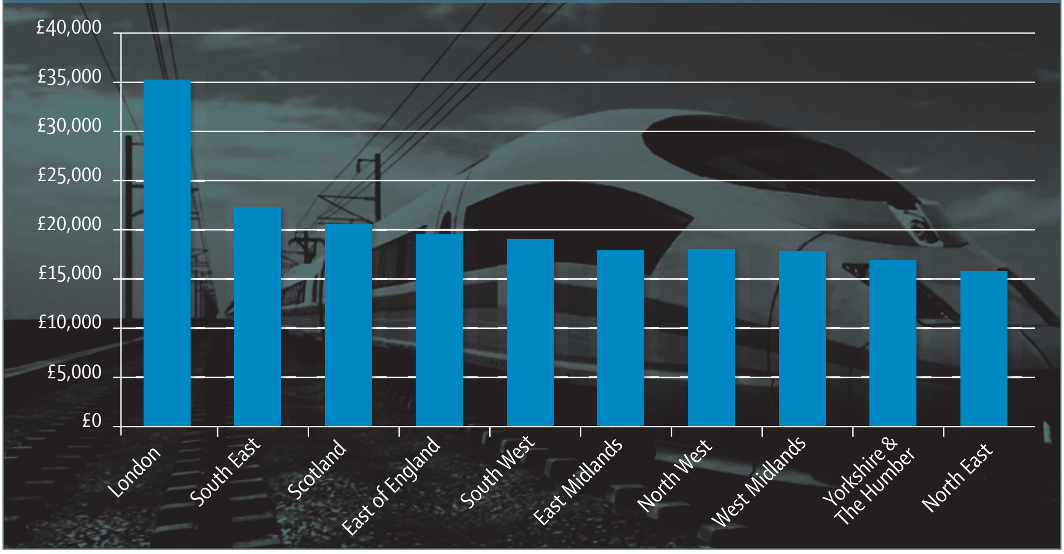
"I am proud to support HS2 – the new north-south line. Just as I'm proud to support it in cities like Sheffield, Leeds, Nottingham, Derby, Glasgow, Birmingham... Now I promise you – I hear the critics. But the truth is we need a new north-south line to make our country stronger."

Patrick McLoughlin, Speech to Conservative Party Conference, 30 September 2013

The Coalition has regularly pledged since taking office to "rebalance the economy" – in both geographic and sectoral terms. Notably, HS2 has begun to be referred to by key Cabinet members as the "North-South line," emphasising that this is part of a wider attempt to bridge the evident economic gap between London and the South East and the rest of the UK, demonstrated starkly in Chart 4.

CHART 4

Gross value added per capita (2011 regional breakdown)



Certainly, city leaders whose cities seem to stand to benefit from HS2 are making their voices heard. Sir Richard Leese, the Labour leader of Manchester City Council, has said, "Manchester and other northern cities will continue to make the case that the project is not just wanted but very much needed."[4] Developments are planned for the areas around HS2 stations – Manchester has designed a 'Piccadilly Boulevard', which has taken influences from New York, Soho and Mexico City, comprising some

[4] "4,500 reasons why Manchester is mad for it," *Daily Express*, October 6 2013.

10,000 homes and a host of new public spaces. It is this surrounding regeneration that the business case relies upon. The accounting firm KPMG, in a report commissioned by HS2 Ltd for £247,000, forecast the resulting economic development around HS2 stations and in the surrounding areas could be upwards of £15bn a year. KPMG's Richard Threlfall suggested in a later Transport Select Committee hearing that the estimate "if anything… was understated."[5]

A number of economists have taken issue with the report's working. Professor Henry Overman at the London School of Economics who describes the methodology as "made up", and Professor Dan Graham at Imperial College told a committee of MPs he didn't believe the statistical work was "reliable."[6] In the report, KPMG assumes that "transport connectivity is the only supply-side constraint to business location", which is to say that it is assumed that there will be developable land available for expansion, that there will be an unlimited pool of skilled workers nearby, and that the Government's own Regional Growth Fund makes no impact whatsoever on the desirability of one location versus another. As the BBC's Business Editor, Robert Peston, notes, these assumptions are a "flaw the size of Greater Manchester in (the) analysis – because KPMG is ignoring one of the fundamental causes of lacklustre growth in many parts of the UK, which is a shortage of skilled labour and of easily… developable land."[7]

And even if KPMG is right, it predicts that a number of areas in the UK will in fact *lose out* after investment in HS2. KPMG representatives have admitted that the economic benefits do not derive from an increase in overall UK employment but from employment moving closer to the line, which raises questions about Government's right to 'pick winners' at a regional economic level.[8] Doubts have also been raised about whether the line, as it is currently planned, can hope to deliver the stated benefits: Birmingham's proposed HS2 station, Birmingham Curzon St, will not directly connect with Birmingham New Street; Sheffield's HS2 station will be located out of town at the Meadowhall Shopping Complex rather than in the City Centre. This is particularly concerning, as most independent studies of high speed rail's impact on regional economies that find a positive conclusion have found that the economic benefits of such schemes are highly concentrated at *the direct expense* of their surrounding regions.[9] Furthermore, as a report penned by Dmitry Sivaev for the Centre for Cities points out, the principles of Paul Krugman's en vogue New Economic Geography suggests that "better connections between central places (i.e.

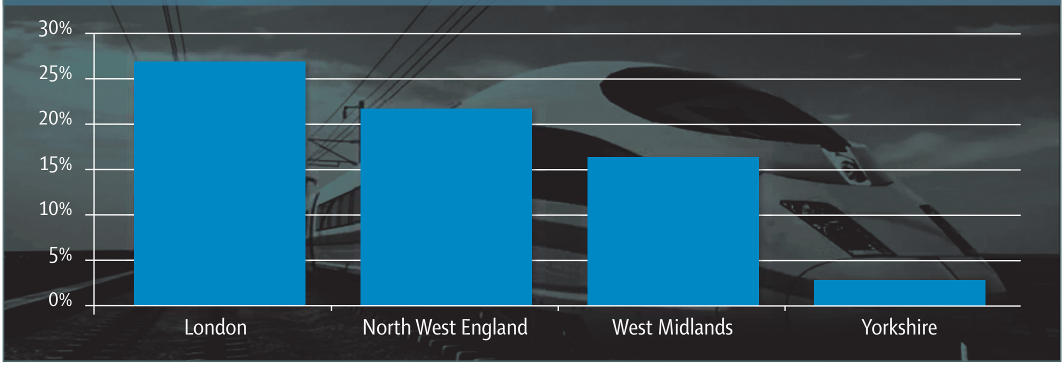
5 Oral Evidence to the Transport Select Committee, KPMG, 26 November 2013.
6 "KPMG defends key HS2 report," *Financial Times*, 5 November 2013.
7 Robert Peston, "What KPMG ignored when arguing for HS2," BBC News, www.bbc.co.uk/news/business-24047047, 11 September 2013.
8 Oral Evidence to the Transport Select Committee, KPMG, 26 November 2013.
9 Chen, C. & Hall, P, "The wider spatial-economic impacts of high-speed trains: a comparative case study of Manchester and Lille sub-regions", *Journal of Transport Geography* (Vol 24, pp. 89-110) 2012.

London) and other areas (i.e. elsewhere in the country) could widen the disparities between their economies.[10] In Lille's case, the prevailing evidence indicates that high-speed rail and public regeneration projects have boosted the central city but its arrival has done little to alleviate the economic woes of surrounding towns and suburbs – a worrying thought for residents of Wolverhampton and Wigan. The impact of HS2 on Lyon, another French city that welcomed the TGV with open arms, is still up for debate.[11] Regardless, Professor John Tomaney believes that in France, "the French capital has gained the most from the creation of a network that has Paris as its central node."[12]

So the evidence, such as it is, suggests two things: that *if* growth occurs in cities served by HS2, it is likely to occur to the detriment of the surrounding region; and that the already strong capital city will be the main beneficiary. Manchester, Leeds and Birmingham already outpace their surrounding areas in economic growth, and evidence suggests HS2 could exacerbate this. Buried in the KPMG report was the admission that, in fact, under the most-likely scenario, London would be the key winner.[13]

CHART 5

Which region of the UK do you believe will derive the greatest economic benefit from HS2?



IoD members are inclined to agree, with London expected to be the prime beneficiary of the near £50bn project, as seen in Chart 5.

Most regions agree that London would be the prime beneficiary, even in those regions that KPMG anticipates will receive substantial benefits.

- In the West Midlands, 34% of IoD members feel that London would benefit the most, compared to 30% thinking the West Midlands would be the prime beneficiary.
- In the North West, 39% feel that the largest benefits would accrue to London, with 35% thinking the North West would win out.
- And in Yorkshire, only 16% think that their region would benefit the most, compared to 29% expecting London to reap the greatest rewards.

Clearly, IoD members doubt the potential for HS2 to have a transformative effect on the UK's worryingly imbalanced economic geography.

[10] Dmitry Sivaev, *HS2 Policy Briefing*, Centre for Cities, October 2013.
[11] Ibid.
[12] Professor John Tamaney, "The Local and Regional Impacts of High Speed Rail in the UK: A Review of the Evidence," *Written evidence to the Transport Select Committee 2010-2012*, 31 May 2011.
[13] KPMG, p. 55.

BOX 1

The Northern Hub

The Northern Hub programme, which will upgrade a series of railways in the north of England, is an interesting example of a smaller-scale, more easily deliverable transport project.

Expected to cost somewhere in the region of £1bn, the programme will include electrifying sections of track, upgrading platforms to allow more carriages, and crucially building a new section of track in the heart of Manchester to connect the nearby airport with suburbs to the north of the city.

The Economist believes the Northern Hub – to be completed in 2019 – is "a good, cheap infrastructure project that should transform a region."[14] Citing anticipated increases in the number of workers travelling from Liverpool to Manchester to Leeds – as well as further afield – *The Economist* suggests that the anticipated benefit:cost ratio of 4:1 is likely to be borne out.

A relatively small-scale but potentially transformative project, the Northern Hub is an example of the kind of focused, crucial upgrade that Sir Rod Eddington called for in 2006. And, as various observers have pointed out, it is significantly cheaper than HS2 and the benefits will be felt most substantially in the Northern economies that need a boost. Would 46 Northern Hub-style projects be a better way to spend taxpayers' money?

TRANSPORT PRIORITIES

As we have previously alluded to, the original argument in favour of HS2 – that faster journey times between our biggest cities would boost the economy in a way that only high speed rail could – has been criticised by a host of diverse organisations.

As a result, the Government has shifted emphasis to an argument that HS2 will alleviate the "capacity crunch" on Britain's railways. The DfT and HS2 Ltd should be congratulated for taking seriously the criticism, and the updated 1000-page business case published in October 2013 was nothing if not a weighty reminder of how committed Government is to the scheme.

The language used in the Secretary of State's foreword is a useful guide to the Government's reasoning and motivation. The Rt. Hon. Patrick McLoughlin writes that, "in terms of ambition, [HS2] stands alongside anything we have ever done as a nation."[15] The Secretary of State is to be commended for considering bold policy options (there are many areas where a little more bravery would be very welcome, not least in expanding the UK's aviation capacity) but that a project is ambitious is not an argument in itself.

The foreword makes it clear that the case for HS2 now rests on "capacity and connectivity." The argument boils down to this:

- The West Coast Main Line, on current projections, will be full in the near future;
- A new line is needed to provide sufficient capacity for passengers and freight;
- If a new line is to be built, it should be high speed as it is not an excessive additional cost;
- If you are going to invest this amount of money, you must maximise the potential benefits.

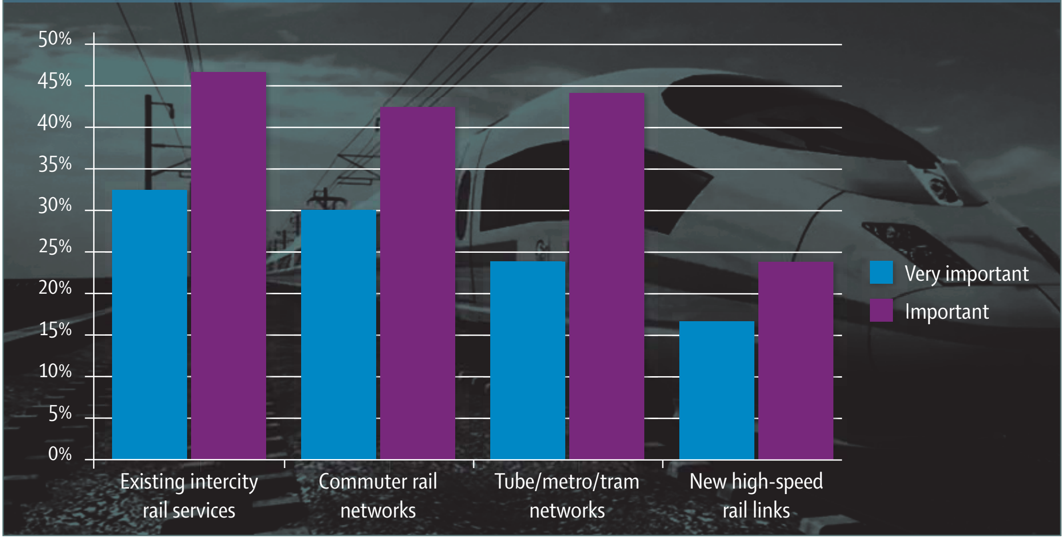
[14] "Manchester united," *The Economist*, 16 March 2013.
[15] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254360/strategic-case.pdf, p. 1.

It is certainly the case that demand for rail travel has grown strongly since privatisation, from around 20 billion passenger miles in 1992/3 to 36 billion in 2012/13. This represents a 54% increase in demand in a 10-year period. The question then is twofold: firstly, do we anticipate these increases will continue? Transport demand forecasting is notoriously unreliable, as anybody who analyses the predictions and realities of passenger ridership on HS1 will testify. Secondly, if we accept that the UK rail network needs additional capacity, where do we put it and how quickly do we want it?

We asked IoD members for their thoughts on these two questions, and the results suggest that the UK's businesses would much rather see investment in existing rail networks rather than new high-speed rail links (Chart 6).

CHART 6

From the perspective of your (primary) organisation, please rate the importance of investing in the following areas of the UK's rail network.



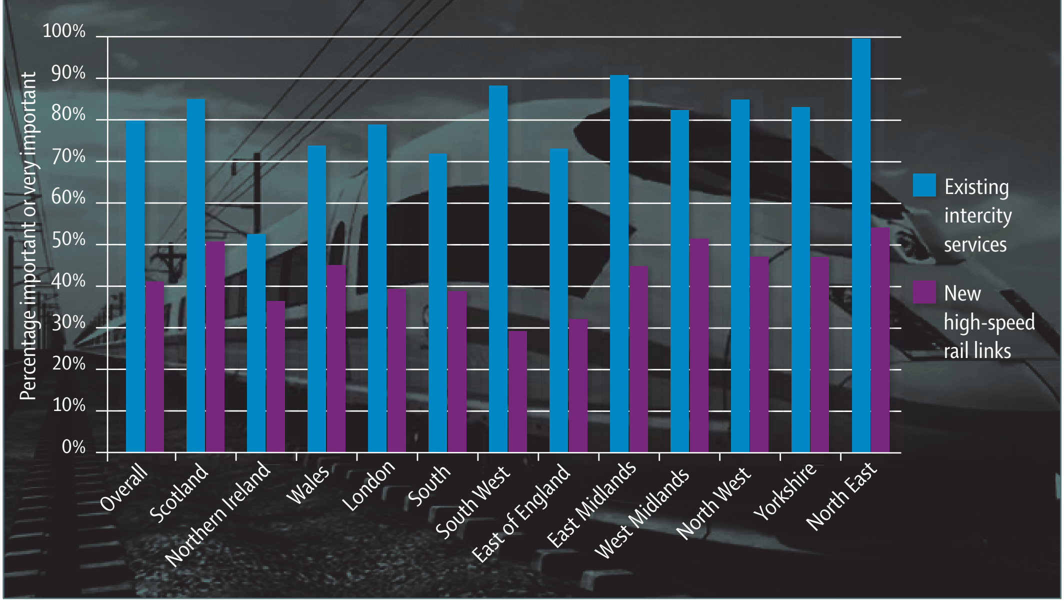
Overall, 80% think that investment in existing intercity rail services is important or very important, while 73% say the same of commuter rail networks. Trailing a long way down the list of member priorities is new high-speed rail-links.

Perhaps most significantly, we were able to compare the results of this 2013 survey with a survey that asked the same question in 2011. The relative importance of investment in the differing areas stayed broadly the same, except for one category; in August 2011, 54% of members rated high-speed rail as important to their business. That number has fallen to 41% in the intervening two years.

There is some regional variation as we can see in Chart 7, but universally, investment in existing services is considered a higher priority than new high-speed links.

CHART 7

Importance of investment in existing intercity services compared to new high-speed rail links – regional breakdown



BOX 2

Disruptive technologies

As anybody who made investments on the back of their belief in Betamax or the MiniDisc will know, even the best laid business plans can fall down when disruptive technologies emerge unexpectedly. The HS2 Ltd 'Economic Case', and the conclusions of the KPMG report, are particularly vulnerable to such disruptive technologies, as they do not consider hypothetical developments in transport infrastructure. Two transport innovations could seriously shake the foundations that the case is founded upon.

Autonomous vehicles

A report by a respected consultancy in 2012 suggested that no longer was the idea of a self-driving vehicle something for science fiction fans. Indeed, "the marketplace will not merely accept self-driving vehicles; it will be the engine pulling the industry forward."[16] Google's driverless cars have logged 400,000 miles without accident in the US; large-scale trials are taking place across Sweden and in Milton Keynes. Advocates suggest driverless cars will be safer, faster, more carbon-efficient than their driven counterparts, and experts anticipate the technology becoming mainstream circa 2030; around the same time that HS2 is due to come on stream. Most interestingly, the aforementioned report suggested "autonomous transportation infrastructure could bring an end to the congested streets and extra-wide highways of large urban areas. ***It could also bring the end to battles over the need for (and cost of) high-speed trains.*** Self-driving vehicles with the ability to 'platoon' – perhaps in special express lanes – might provide a more flexible and less costly alternative."[17] The British Government is on board, too, announcing in the National Infrastructure Plan that it will conduct a review to ensure that the "legislative and regulatory framework demonstrates to the world's car companies that the UK is the right place to develop and test driverless cars."[18] The Department for Transport's 'Roads' team said earlier in 2013 that we are "potentially on the verge of a great change" in the way the road network works – creating a low-carbon, high-speed road network across the UK.[19] Certainly anyone who has used the 'Personal Rapid Transit' autonomous pods at Heathrow Airport, designed by the innovative British company Ultra, can vouch for the potentially transformative technology of automated transit.

[16] *Self-driving cars: The next revolution*, KPMG and the Center for Automotive Research, 6 August 2012, p. 8.
[17] *Self-driving cars*, KPMG p. 26.
[18] HM Treasury, *National Infrastructure Plan 2013*, (December 2013) p.65.
[19] Department for Transport, *Action for Road*, (13 July 2013).

BOX 2 (continued)

Disruptive technologies

Self-driving cars may not be the revolutionary technology that its advocates suggest. But writing a business plan without even considering the possibility of an alternative, disruptive technology seems to us unwise. What makes this all the more surprising is that the 2012 report that suggested self-driving cars could spell the end of high-speed rail was written by KPMG; precisely the same firm that, one year later, suggested that only high-speed rail can transform the UK's economic landscape.

Lift sharing

The idea of jumping in a car with a stranger might seem anathema, but French company BlaBlaCar has proved such a hit that the chairman of SNCF, the French national rail operator, has named it as one of the greatest new threats to his company. It provides an online platform in which drivers can sell seats in their car, and according to their founders, transport more than one million people across Europe every month. BlaBlaCar is looking to build its business in the UK in 2014, joining UK-based Liftshare in the market. Such firms are unlikely to replace the need for rail connections, but the point to be made is that basing a decision to spend some £50bn of taxpayers' money on the back of a business case that has not engaged in contingency planning seems distinctly unwise.*

VALUE FOR MONEY

We live in straitened times, with a massive budget deficit threatening to destabilise Britain's economic future. Despite good work over the past three years cutting the deficit, it is still worryingly high.

The Institute of Economic Affairs has predicted that the overall cost of the project could hit £80bn by the time it is completed; Boris Johnson suggested £70bn.[20] Even the incoming chairman of HS2 Ltd, Sir David Higgins, has said the budget may well end up higher.[21] The Government's current budgetary ring-fence is for £42.6bn (including a £12.7bn contingency) and an additional £7.5bn for the rolling stock.

Business leaders recognise the importance of value for money, never more so than in tough times. IoD members were asked whether the public spending to be devoted to HS2 passed the rigorous test they would apply to their own investments (Chart 8).

CHART 8

Do you believe the public spending required to build HS2, and provide the rolling stock, would represent:

* The author wishes to acknowledge the support of Chris Belk and Fraser Brown in this section.

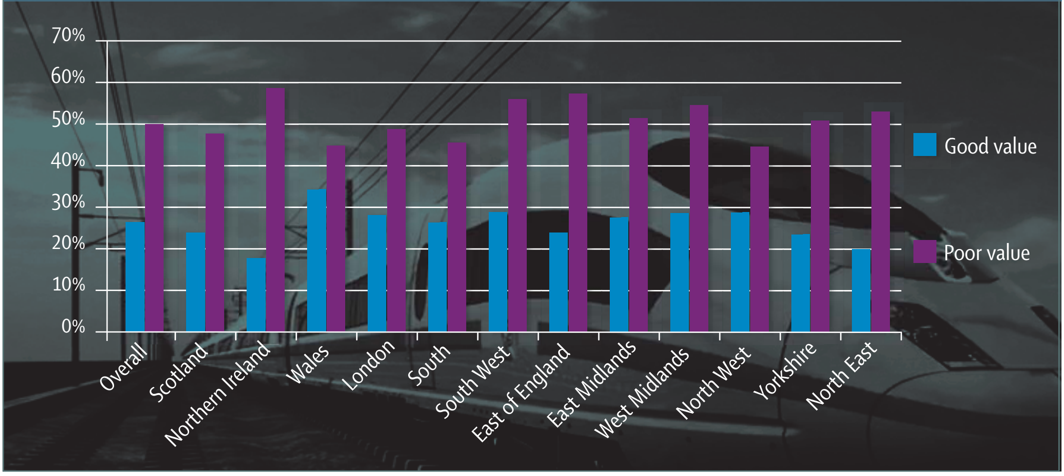
[20] Dr Richard Wellings, Institute of Economic Affairs, *The High-Speed Gravy Train: Special Interests, Transport Policy and Government Spending*, 19 August 2013.

[21] Christopher Hope, "HS2 'will cost over £70bn', says Boris Johnson," *Daily Telegraph*, 7 July 2013.

Overall, then, a good half of IoD members believe HS2 is poor value for money compared with 27% who think it offers good value. As with the other questions asked of members, there is only minimal deviation at the regional level and, noticeably, those in the West Midlands were more critical than average (Chart 9).

CHART 9

Perceptions of the value for money of HS2 – regional breakdown

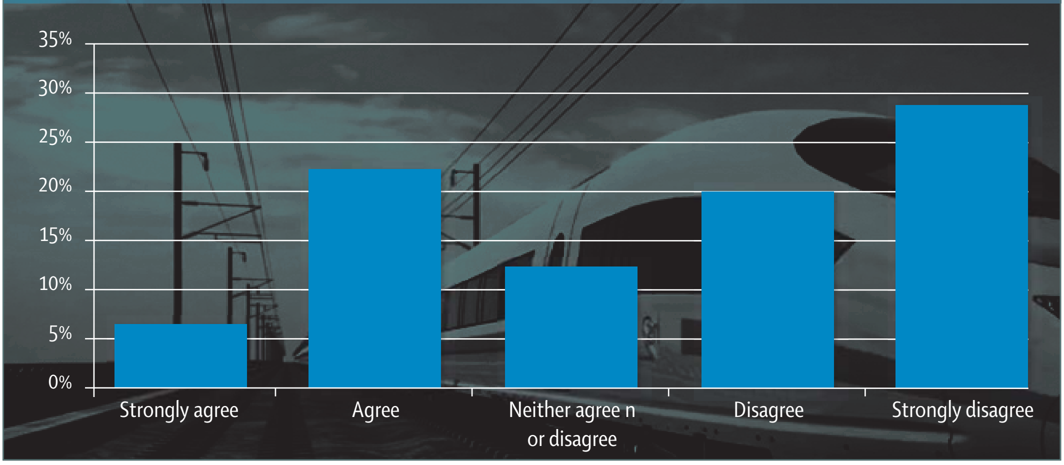


Even at the current estimates – which have been, as we have seen, described as optimistic by a number of commentators – IoD members have not been persuaded that the taxpayer is getting the greatest value out of £50bn with the building of HS2.

In a similar vein, IoD members were asked if they felt the projected benefits of HS2 would negate their concerns about the high costs. We have seen that few members believe HS2 will impact their productivity, nor that it would rebalance the economy, and nor do they think it is the top rail infrastructure priority, so it is unsurprising that IoD members on the whole do not believe the benefits will outweigh the costs (Chart 10).

CHART 10

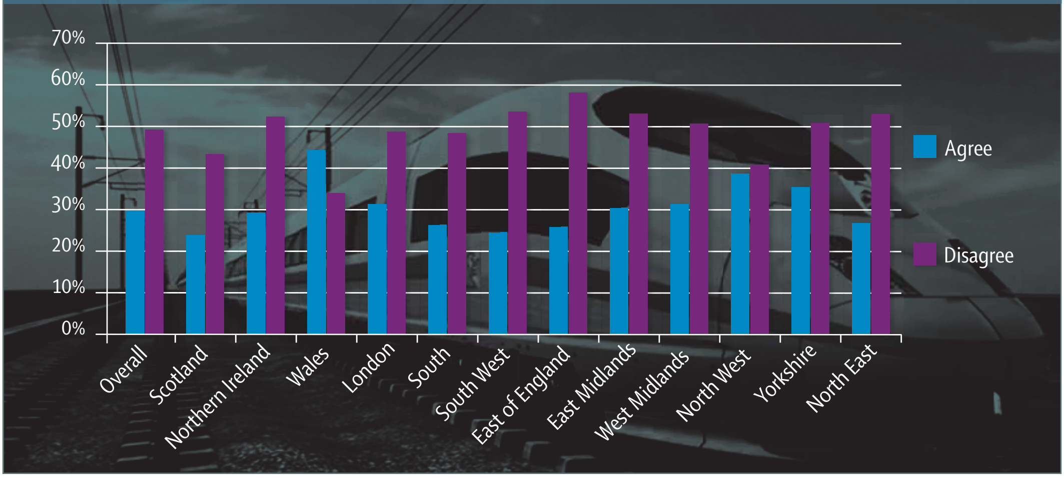
To what extent do you agree or disagree with the following statement about HS2? "The economic benefits of HS2 will outweigh the costs of construction and rolling stock."



- Overall, 30% believe the benefits outweigh the costs, but nearly half (49%) believe the opposite.
- With the exception of Wales, business leaders in all regions tend to disagree with the Government's contention that the economic benefits of HS2 outweigh the costs. Again, both of the Midlands regions were particularly sceptical (Chart 11).

CHART 11

Extent of agreement that the economic benefits of HS2 outweigh the costs – regional breakdown

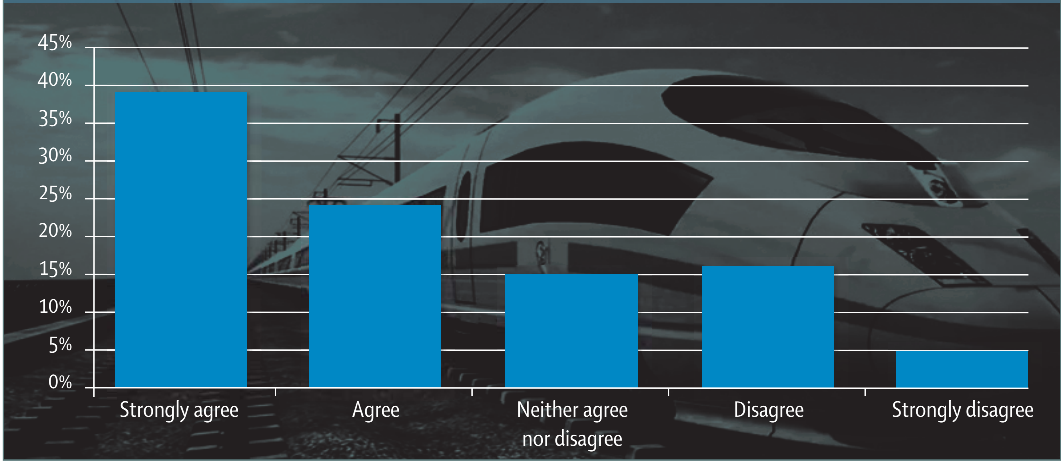


CONCLUSION: THE UK NEEDS INFRASTRUCTURE INVESTMENT – BUT NOT HS2

It is an axiom among business leaders that Britain does not have adequate transport infrastructure, and that decisions on the future of our infrastructure are left to wither in the long grass. The first Government report describing Heathrow as in need of expansion saw the light of day in 1978; Crossrail was first mooted in 1974. HS2 is, at the very least, a rare example of a Government totally committed to an infrastructure project.

CHART 12

Do you agree or disagree with the following statement about HS2? "The budget earmarked for the construction of HS2 would be better used to improve other parts of the UK's rail and road network"



But it is not the infrastructure project Britain needs, nor that British business wants. In a world in which civil servants and ministers are digging around down the back of HM Treasury's sofas, IoD members would rather see £50bn spent on bringing Britain's existing transport infrastructure into the 21st century (Chart 12).

The IoD understands that there are businesses that will benefit from HS2. Our contention, drawn from our members' views, is that *not enough businesses* benefit; certainly not enough to warrant the vast sums the project is anticipated to cost. Across the country, there simply is not the level of business support to justify blowing Britain's infrastructure budget on a project with such potential to turn into a white elephant.