House of Commons

Committee of Public Accounts

HM Treasury: Planning for economic infrastructure

Forty-second Report of Session 2012–13

Report, together with formal minutes, and oral evidence

Ordered by the House of Commons to be printed 15 April 2013

HC 872
Published on 29 April 2013
by authority of the House of Commons
London: The Stationery Office Limited
£10.00

Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine "the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit" (Standing Order No 148).

Current membership

Rt Hon Margaret Hodge (*Labour, Barking*) (Chair)
Mr Richard Bacon (*Conservative, South Norfolk*)
Stephen Barclay (*Conservative, North East Cambridgeshire*)
Guto Bebb *(Conservative, Aberconwy)*
Jackie Doyle-Price (*Conservative, Thurrock*)
Chris Heaton-Harris (*Conservative, Daventry*)
Meg Hillier (*Labour, Hackney South and Shoreditch*)
Mr Stewart Jackson (*Conservative, Peterborough*)
Fiona Mactaggart (*Labour, Slough*)
Austin Mitchell (*Labour, Great Grimsby*)
Sajid Javid (Conservative, Bromsgrove)
Nick Smith (*Labour, Blaenau Gwent*)
Ian Swales (*Liberal Democrats, Redcar*)
Justin Tomlinson *(Conservative, North Swindon)*

The following Members were also Members of the committee during the parliament:
Dr Stella Creasy (*Labour/Cooperative, Walthamstow)*
Justine Greening (*Conservative, Putney*)
Joseph Johnson *(Conservative, Orpington*)
Eric Joyce (*Labour, Falkirk*)
Rt Hon Mrs Anne McGuire (*Labour, Stirling*)
Matthew Hancock (*Conservative, West Suffolk*)
James Wharton (*Conservative, Stockton South*)

Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/pac. A list of Reports of the Committee in the present Parliament is at the back of this volume.
Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee is Adrian Jenner (Clerk), Sonia Draper (Senior Committee Assistant), Ian Blair and James McQuade (Committee Assistants) and Alex Paterson (Media Officer).

Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee's email address is pubaccom@parliament.uk

Contents

Summary

Infrastructure UK, an advisory unit within the Treasury, was established in 2010 with a remit to specify what economic infrastructure is needed in the UK, to identify the key barriers to achieving that investment and to mobilise systems and resources, both public and private to make it happen. The first National Infrastructure Plan was published in 2010. The latest update of the plan, published in December 2012, comprised over 500 prospective programmes and projects for new economic infrastructure expected to cost £310 billion. Some 64% of this amount is expected to be spent on infrastructure that will be wholly owned and financed by the private sector. Consumers will bear most of the cost of this new infrastructure through bills for utilities and other services.

Investment in economic infrastructure is needed to replace ageing assets, improve public services and stimulate economic growth. Many of the investment proposals impact on energy supply and are therefore particularly time critical. We believe that this will lead to higher costs which will be borne by consumers. We are particularly concerned at the impact of higher energy bills on those with low incomes. However, we are not convinced that the current proposals represent a rigorous plan with clear priorities for action or with a clear programme for delivery.

The Treasury has identified 40 key projects and programmes. However, many of the programmes are broad categories and in total they include more than 200 individual projects. This does not suggest a properly targeted and prioritised infrastructure plan. The Treasury will need to work more forcefully with departments, regulators, contractors and investors to agree the priorities for the projects that will be undertaken and the ways in which the costs both for consumers, through bills, and taxpayers, through various forms of support, will be identified and contained. This needs to be addressed urgently.

The Government also needs to ensure that the legislative and regulatory framework provides sufficient certainty to secure the necessary private sector investment in a climate where the competition for capital is internationally competitive. In this regard the statutory framework provided by the Energy Bill is coming rather late in the day when the energy crunch is fast approaching. It is likely that the UK will buy ever more energy from overseas and at a higher price due to the failure to secure investment.

Most of the economic infrastructure investment required will be in the private sector using investment supported by government with households bearing the costs through higher bills or fares. In these circumstances greater transparency is needed over investors' costs, risks and rewards and more information is required on the long term costs falling on consumers in a form that will allow them to judge how they might respond.

On the basis of a report by the Comptroller and Auditor General,[1] we took evidence on Planning for Economic Infrastructure from participants in the infrastructure sector, the Treasury, the Department for Transport and the Department for Energy and Climate Change.

1 C&AG's Report, *Planning for economic infrastructure*, Session 2012-13, HC 595

Conclusions and recommendations

1. **The Treasury's Infrastructure Plan is a list of projects, not a real plan with a strategic vision and clear priorities.** We are not convinced that a plan requiring £310 billion of investment in infrastructure is credible given the current economic climate, the cutbacks in public finances and the difficulty in raising private finance for projects on acceptable terms. The Treasury maintains that it has prioritised 40 projects and programmes, but as many of these programmes encompass broad areas this list covers over 200 individual projects whose relative priority is not clear. Given the financial constraints affecting both the government and consumers' ability to fund infrastructure expenditure on this scale, the Treasury should assess how much investment can realistically be financed and develop a coherent strategy using tightly defined criteria to identify and prioritise projects.

2. **Uncertainty over government policy can deter or delay investment in infrastructure projects and lead to additional costs**. Investors will be reluctant to invest in projects until government policy is clear and consistent. They will be reluctant to invest if they are concerned that future policy changes may affect them adversely or they may require a higher return to reflect this risk. Government plans are inevitably subject to change, but unexpected changes create unnecessary investor uncertainty. The removal of the exemption from the 2009 Climate Change Levy for some combined heat and power plants in the 2012 Budget when investors had been assured the exemption would last until 2023 is an example of such a change that affected investment returns. The Treasury should work with departments to ensure that the consideration of policy proposals takes into account their potential impact on infrastructure investment and that unexpected changes are minimised to provide greater certainty to investors over government plans.

3. **It is not clear what level of Government support will be required to ensure that these investment projects proceed.** In order to attract the private finance required to implement these infrastructure projects at a reasonable cost the Government may have to provide different forms of support including direct grants, guaranteed prices for outputs, or agreeing to bear certain risks. The Treasury and departments should identify the support that will be required and the costs involved. Government support will be paid for by either the taxpayer or the consumer so openness and clarity about the impact of Government decisions is essential.

4. **Investors must accept some degree of transparency over their costs, risks and rewards in delivering infrastructure projects given that the costs of government support will ultimately fall on taxpayers and consumers.** Most economic infrastructure investment takes place in a private sector market where investor returns are often supported by government and households bear the costs of infrastructure in their bills. In return, investors should provide sufficient information to show that their returns are reasonable and that any government support is justified. The Treasury should require investors to supply the information needed to facilitate this transparency and should reserve the right to audit such information.

5. **Consumers will bear the brunt of the costs of the projects in the Infrastructure Plan through higher charges but the burden they face has not been quantified.** Most of the costs of economic infrastructure will fall on citizens as consumers rather than taxpayers. With household budgets under pressure consumers have limited scope for adjusting their spending on costs arising from infrastructure investment in many areas such as utility bills and fares. The Treasury should identify the impact of planned infrastructure expenditure on the disposable incomes of different types of households.

1 Shortcomings in the Treasury's current infrastructure plan

1. Economic infrastructure includes power generation facilities, roads, railways, airports, ports and communication systems. Investment in new economic infrastructure is needed to replace ageing assets and to develop improved services. It is also at the heart of the Government's policies to promote economic growth.[2]

2. In 2010 the Government created a new advisory unit within the Treasury—Infrastructure UK—to bring further focus to the Government's strategic approach to ensuring appropriate economic infrastructure is developed. It was tasked with producing, developing and pursuing a National Infrastructure Plan to specify the infrastructure that is needed, the barriers to achieving that investment and to mobilise resources, both public and private, to make it happen.[3]

3. The current National Infrastructure Plan[4] is basically a list of a large number of projects rather than a clear centrally developed strategy explaining the case for which projects should be prioritised in the current challenging economic environment. The Plan reflects planned infrastructure investment identified by Infrastructure UK of £310 billion set out in a "pipeline" of over 500 projects.[5]

4. The Treasury told us that there are 40 priority projects and programmes. However, these programmes include large numbers of projects so that in total over 200 projects are priorities.[6] We have not seen evidence that a plan for such a large volume and value of projects is credible given the current challenges in raising finance to take forward projects and the limits on the costs that can be borne by taxpayers and consumers.[7]

5. Witnesses identified three particular areas of difficulty in planning for economic infrastructure. The first is how to plan for infrastructure of an appropriate scale to stimulate growth whilst taking account of economic uncertainties which may place limits on how much new infrastructure is required. These uncertainties include the likely demand if there is no growth and the burden that new infrastructure investment may place on consumers.[8] The rate of investment also needs to be credible taking account of previous spending patterns and the capacity to change them. The Department for Energy and Climate Change told us that it would have to raise the annual rate of investment in energy

2 C&AG's Report, paras 2,1.2

3 C&AG's Report, para 4

4 HM Treasury National Infrastructure Plan: update 2012, December 2012, available athttp://www.hm-treasury.gov.uk/d/national_infrastructure_plan_051212.pdf

5 Q 75, 80, 82-83

6 Q78

7 Qs76,80

8 Qs 91-95,101-103,113,148

infrastructure from the £10 billion secured in 2011 if the Government was going to meet the nation's energy needs.[9]

6. The second difficulty is that on certain projects there is often a long period before building work starts. The first diggers are not expected to start on the High Speed Rail Link 2 until 2018 and experience suggests that is an optimistic start date. Although such projects are expected to benefit economic growth in the longer term the long preparation time delays the short term imperative to stimulate economic growth through construction work.[10]

7. The third difficulty is managing the trade-offs between alternative types of infrastructure investment. For example, the basis for prioritising road or rail investment needs to be clearly articulated. This requires balancing issues such as where demand will be greatest, the payback period (roads maintenance for example has a very fast payback period) and the need for spending on very large single projects which will reduce the amount of funds available for smaller projects.[11] Similarly, the plan needs to articulate how decisions are made on the amount of infrastructure investment in the regions as opposed to London and the South East.[12]

9 Qs 110-113

10 Qs146-148

11 Qs149-154,164,166,169-170

12 Qs 165-166,168,180

2 Government's engagement with the market

8. The Government expects 64% of its planned investment in economic infrastructure to be wholly owned and financed by the private sector.[13] In such cases the government's role is to put in place the conditions required to encourage private firms to make the necessary investment, and to assist the national and international investment community to provide finance on viable terms.[14] Investors will decide whether to invest in UK infrastructure based on their assessment of risk and returns.[15]

9. Investors told us that there were aspects of the UK infrastructure market which encouraged investment. For example, the networks for transmitting water and energy, where investor returns were regulated and relatively predictable, created a stable environment which made it easier to obtain debt finance more cheaply.[16] However, they noted that for them to invest in other areas of public infrastructure would require greater clarity over government policy. E-ON told us it would continue to defer decisions on energy generation investment until the Energy Bill had been enacted and there was clarity over the extent to which the Government would support wind power. This support may involve guaranteeing payments to the generators for the capacity they provide irrespective of whether the conditions are right for wind power to be generated.[17] We have already voiced our concerns over similar guaranteed revenue arrangements for companies involved in the transmission of electricity from offshore wind power.[18]

10. Investors are looking for government policy to encourage investment in low-carbon energy generation, which would be consistent and stable over time. The investors are also concerned that there should be agreement across political parties on the policy underpinning infrastructure investment to reduce the risk of changes in plans in the event of a new government.[19]

11. Uncertainty can also arise within a Parliament if Government chooses to change current policy. For example, E-ON told us that it had suffered a financial penalty on an investment it had already made in combined heat and power stations when the 2012 Budget removed levy exemption certificates[20] which the 2009 Budget had said would be available until 2023.[21] The removal of the levy exemption certificate made the energy E-ON

13 The 64% that is expected to be wholly owned and financed by the private sector includes investment by Network Rail whose financing is underwritten by the public sector.

14 C&AG's Report para7

15 Qs 1,20,33-34

16 Qs32-34

17 Qs12-16

18 PAC report HC621 (2013) : 20th Report: *Department of Energy and Climate Change: Offshore Electricity Transmission-A New Model*

19 Qs1,34,59,70,90

20 The climate change levy is a tax on energy payable by the end users in industry, commerce and the public sector. The tax is not payable where the energy supplied has qualified for a levy exemption certificate as coming from a renewable energy source.

21 Q 60

was supplying more expensive for the end user which affected the demand for this type of energy and E-ON's return on its investment. The Committee was aware that other companies will have similarly faced large unexpected losses from this change in government policy.[22]

12. Overall there is a scarcity of finance to take forward economic infrastructure projects. The public finances are constrained and it is also difficult to raise money in the private sector. This suggests that a more rigorous approach to prioritisation is needed.[23]

13. The Government is seeking to attract new sources of finance, particularly from pension funds. Government infrastructure should be a good investment for pension funds because it provides a stable long term revenue stream which increases each year by amounts which are related to inflation.[24] However, the National Association of Pension Funds (the Association) told us that, despite this attraction, there had been drawbacks for its members investing in infrastructure funds: high fees for the funds' managements, high amounts of debt which could create volatility in project returns and an investment strategy of making an early sale of investments rather than holding them for the long term.[25]

14. To overcome these difficulties the Association had signed a memorandum of understanding with the Treasury in November 2011 to build a new fund for investing in infrastructure. This new fund would enable the pension funds to utilise their collective buying power and would suit the needs of pension funds with low fees, low amounts of debt and long term returns of 2-5% above changes in the Retail Price Index.[26] The pension funds would want certainty over these returns from the government as they were not interested in taking risk.[27]

15. To secure private sector finance from parties such as pension funds which are seeking low risk investments, the government will either pay more to encourage them to invest or will need to take on more risk in the public sector to raise the finance. That may involve the government in providing subsidies or guarantees. The Government has said it is prepared to make available guarantees of £40 billion.[28] But it is not clear what the total cost of government support will be and there are limits as to how far these forms of taxpayer support can be provided when the Government is trying to reduce the deficit and publicly financed capital investment is also being reduced. [29]

16. A particular concern is that in seeking to secure the increased infrastructure investment which Infrastructure UK has identified in its current National Infrastructure Plan taxpayers' money may be used to incentivise private investment in a way that leads to excess profits in the private sector at the expense of the taxpayer or consumer.[30] If investors

---

22 Qs115-118

23 Q76

24 Q47

25 Qs47-51

26 Q51

27 Qs53-59,72-74

28 Qs 96, 141

29 Q96

30 Q141

receive a government guarantee over their revenue stream this may encourage them to commit their money; but it also creates an opportunity for them to benefit by capitalising their income stream and making a large and early profit on their investment which may not be shared with the public sector. This is a concern we noted in our report on offshore wind power transmission where it appears that consumers will pay a heavy price in their energy bills for attracting private investment..[31]

17. A balance has to be struck between encouraging investors to participate in UK infrastructure projects and the reasonableness of their returns for doing so bearing in mind the risks involved. The investors we examined would not disclose the minimum returns, the "hurdle rate", they seek from projects.[32] While they are not under any contractual obligation to provide this information they are, nevertheless operating in markets where their activities may be receiving taxpayer support and where the ultimate cost of their projects will be borne by consumers. In addition, co-operation and transparency between the government and investors are needed to ensure that projects which will be paid for by consumers are taken forward in a cost efficient manner so that consumers are not burdened with high bills..[33]

31 Q25 and PAC Report: HC621 (2013) : 20th Report: Department of Energy and Climate Change: Offshore Electricity Transmission-A New Model

32 Qs39-41

33 Q43

3 The impact on consumers

18. Because the Government expects most new economic infrastructure to be wholly owned and financed by the private sector much of the cost of new infrastructure will fall on consumers rather than taxpayers.[34] There are difficulties in trying to estimate what the impact on consumers will be of future infrastructure investment. Policy decisions will affect infrastructure investment and the costs of certain types of infrastructure that will be built in the future are currently unknown. [35]An example is nuclear power generation where the unpredictability and constant escalation of costs makes cost estimation difficult.[36]

19. Consumers have already been hit by rising energy bills owing to increases in world energy prices before taking account of the additional impact of the cost of infrastructure investment.[37] There has been no overall assessment by Government of the future impact of infrastructure spending on consumers. Affordability has been judged and addressed in individual sectors such as energy although these sector assessments have contained considerable uncertainty. Infrastructure UK initially planned to develop an overall framework for judging affordability but subsequently decided it was not feasible to establish such an overall framework.[38] The Treasury argues that there are a range of factors, not just infrastructure, that affect households' cost of living. These include council tax, import prices and the devaluation of sterling. The Treasury considers, therefore, that the cost of living has to be monitored through a broad affordability framework but has not ruled out a framework just focussing on the aggregate impact on consumers of infrastructure spending.[39]

20. Those on low incomes are particularly at risk from the impact that infrastructure spending may have on consumer bills. The Treasury is concerned about the impact of costs on the poorest people. The Government already supports citizens on low incomes through initiatives such as the Warm Homes Initiative and Winter Fuel Payments for pensioners. If new infrastructure investment adds to future household bills then this will raise further issues about the distributional effect of the costs on consumers.[40]

21. The Treasury also has to consider the macroeconomic effect of increased prices that may arise from infrastructure spending. The Treasury told us that some of the estimates as to why the economy is still 6% smaller than before the economic crisis is the rise in household bills and the impact this has had on living standards and consumer spending.[41]

34 C&AG's Report para 17

35 Q161

36 Q8

37 C&AG's Report paras 3.2-3.3, Qq 97-98, 175

38 C&AG's Report para 17

39 Q162

40 Q102

41 Q102

Formal Minutes

Monday 15 April 2013

Members present:

Margaret Hodge, in the Chair

Stephen Barclay	Fiona Mactaggart
Jackie Doyle-Price	Austin Mitchell
Meg Hillier	Nick Smith
Mr Stewart Jackson	Justin Tomlinson

Draft Report (*HM Treasury: Planning for economic infrastructure*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 21 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Forty-second Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 22 April at 3.00 pm

Witnesses

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2012–13

First Report	The Government Procurement Card	HC 1915
Second Report	Mobile Technology in Policing	HC 1863
Third Report	Efficiency and reform in government corporate functions through shared service centres	HC 463
Fourth Report	The completion and sale of High Speed 1	HC 464
Fifth Report	The Regional Growth Fund	HC 104
Sixth Report	HM Revenue & Customs: Renewed Alcohol Strategy	HC 504
Seventh Report	Immigration: The Points Based System – Student Routes	HC 101
Eighth Report	Managing early departures in central government	HC 503
Ninth Report	Preparations for the London 2012 Olympic and Paralympic Games	HC 526
Tenth Report	Implementing the transparency agenda	HC 102
Eleventh Report	Improving the efficiency of central government office property	HC 288
Twelfth Report	Off-payroll arrangements in the public sector	HC 532
Thirteenth Report	Financial viability of the social housing sector: introducing the Affordable Homes Programme	HC 388
Fourteenth Report	Assurance for major projects	HC 384
Fifteenth Report	Preventing fraud in contracted employment programmes	HC 103
Sixteenth Report	Department of Health: Securing the future financial sustainability of the NHS	HC 389
Seventeenth Report	Department of Health: The management of adult diabetes services in the NHS	HC 289
Eighteenth Report	HM Treasury: The creation and sale of Northern Rock plc	HC 552
Nineteenth Report	HM Revenue & Customs: Annual Report and Accounts 2011-12	HC 716
Twentieth Report	Department for Energy and Climate Change: Offshore electricity transmission–a new model for infrastructure	HC 621
Twenty-first Report	The Ministry of Justice's language service contract	HC 620
Twenty-second Report	British Broadcasting Corporation: Off-payroll contracting and severance package for the Director General	HC 774

Twenty-Third Report	Department for Work and Pensions: Contract management of medical services	HC 744
Twenty-Fourth Report	Nuclear Decommissioning Authority: Managing risk at Sellafield	HC 746
Twenty-Fifth Report	Funding for local transport: an overview	HC 747
Twenty-Sixth Report	The Department for International Development: The multilateral aid review	HC 660
Twenty-Seventh Report	HM Treasury: Annual Report and Accounts 2011–12	HC 659
Twenty-Eighth Report	Department of Health: The Franchising of Hinchingbrooke Health Care NHS Trust and Peterborough and Stamford Hospitals NHS Foundation Trust	HC 789
Twenty-Ninth Report	Tax avoidance: tackling marketed avoidance schemes	HC 788
Thirtieth Report	Excess Votes 2011–12	HC 959
Thirty-first Report	Department for Transport: Lessons from cancelling the InterCity West Coast franchise competition	HC 813
Thirty-second Report	Ministry of Defence: managing the defence inventory	HC 745
Thirty-third Report	The Work Programme	HC 936
Thirty-fourth Report	Managing Budgeting in Government	HC 661
Thirty-fifth Report	Restructuring the National Offender Management Service	HC 717
Thirty-sixth Report	HMRC: Customer Service	HC 869
Thirty-seventh Report	Whole of Government Accounts 2010-11	HC 867
Thirty-eighth Report	The impact of Housing Benefit reform	HC 814
Thirty-ninth Report	Progress in delivering NHS efficiency savings	HC 865
Fortieth Report	The London 2012 Olympic Games and Paralympic Games: post–Games review	HC 812
Forty-first Report	Department for Education: Managing the expansion of the Academies Programme	HC 787

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 6 February 2013

Members present:

Margaret Hodge (Chair)

Guto Bebb	Austin Mitchell
Jackie Doyle-Price	Nick Smith
Meg Hillier	Ian Swales
Fiona Mactaggart	Justin Tomlinson

Amyas Morse, Comptroller and Auditor General, **Gabrielle Cohen**, Assistant Auditor General, and **David Finlay**, Director, National Audit Office, were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

Planning for Economic Infrastructure (HC 595)

Examination of Witnesses

Witnesses: **Richard Abel**, Managing Director, Macquarie Infrastructure and Real Assets (MIRA), **Joanne Segars**, Chief Executive, National Association of Pension Funds, and **Sara Vaughan**, Director of Strategy and Regulation, E-on, gave evidence.

Q1 Chair: Welcome. Sorry we are a little late. A big thank you to the three of you for coming to this first part of our session this afternoon on infrastructure. We can see that we have got a good team sitting in front of us. We use this first bit of the session not to try to catch you out but to see what your take is as stakeholders in the infrastructure landscape and what you think we should be asking of those we hold to account.

Everybody accepts that growth and infrastructure investment is absolutely vital, both now and to stimulate growth in the economy. I will start with Sara. A lot of our Report is about investment in the energy market. What is going wrong? We have just had somebody else pull out of nuclear; Centrica pulled out yesterday. What is going wrong, and what is it that means that you are not investing as much as we need, with all the fears that we have about future capability? What is it, and what should Government be doing? Where are the problems?

Sara Vaughan: It is probably wrong to characterise it as something going wrong. I think it is very fair to say that at the moment, we in the energy industry are probably in a slight hiatus, because we are going through electricity market reform which seeks to put in place the right sort of framework to encourage energy companies to invest in low-carbon generation and ultimately in fossil fuel generation also.

For that to work, we need certainty that the policy put in place will be stable and will last for a number of years so that we can invest on the back of it, and that there is political stability around it. By that I mean that it is not something on which the parties disagree with one another across Parliament. We also need to ensure that the right messaging is given out to people and the right steps are taken in terms of positive action on things like planning.

You mentioned the decision by Centrica to pull out of building new nuclear. Clearly, I cannot comment on the reasons why Centrica pulled out, but my own company pulled out of building new nuclear last year, and we were very clear at the time that that had absolutely nothing to do with any lack of confidence in the framework that the Government was putting in place. We believed that it was a good framework, and one on the back of which people could invest in nuclear. It just reflected the circumstances of our company at the time. Indeed, to me, the fact that we managed to sell our project to Hitachi, a brand-new investor into the UK in this sector, shows that the Government are actually getting it right. We need to get on with it, but—

Q2 Chair: Why aren't you? All the stats I look at say to me that the future energy supply not very far down the road is very fragile: 20% of existing power stations are going to go out of service by 2050. So why aren't you? The second thing is that you talk about stability. I am trying to think how many energy plans we have had in the last decade.

Sara Vaughan: Quite a few.

Q3 Chair: How many? I literally do not know.

Sara Vaughan: I do not know the answer to that question.

Q4 Chair: Probably five or six. That is the world in which you are living. We in this Committee get rather irritated by everybody saying, "This one is the definite plan, and it's never going to change." We cannot see any assurance that life has really moved on.

Sara Vaughan: There is a very nice statistic that people always used to quote around Energy Ministers about the number of different Energy Ministers that we had had. That really goes to my point about why political stability is so important.

Q5 Chair: Well, you are not going to get it. You can ask for it, you can welcome the latest of the plans and you can hope that this will be more stable than previous plans, but what is going to make you invest? We do not want the lights to go out.
Sara Vaughan: We are investing. We have invested over £4.5 billion in the UK in the past five years. In 2011–12, we invested over £1 billion.

Q6 Jackie Doyle-Price: Which kind of generation?
Sara Vaughan: Mostly renewable. In fact, I think pretty totally renewable.

Q7 Jackie Doyle-Price: Which renewable? Wind?
Sara Vaughan: Wind and biomass. Offshore and onshore wind. But we have some £4.7 billion-worth of investment in development, and we have £2.7 billion in operational or under construction, just recently built, so it is completely wrong to characterise it that people are not investing in the industry.

Q8 Austin Mitchell: The problem with the nuclear issue is not political uncertainty; it is the costs. We don't know, because costs are constantly escalating. There is a cost to dismantling the plants, which we found would be higher at Windscale than was being estimated. There is the cost of disposal of the nuclear waste, which is a problem we haven't solved. It is the unpredictability of the costs and the costs of construction, like the nuclear plant building in Finland, which has escalated constantly. That is the problem, isn't it?
Sara Vaughan: Nuclear, if it is built efficiently, actually is very competitive with the rest of the technologies on the system.

Q9 Austin Mitchell: Yes, but they are all competing to pull out.
Sara Vaughan: It is cheaper than offshore wind and it is quite comparable with onshore wind, but it has to be done properly. The costs of decommissioning and waste disposal, in the greater scheme of building a nuclear project, are actually relatively small. What we have in the UK, and none of the new developers is responsible for this, is a great legacy problem of nuclear waste.
Amyas Morse: I want to ask—pardon me, but I want to make sure I have understood you, Ms Vaughan—about when you mentioned we've got to get on with it. Then you proceeded to characterise everybody as doing their part in an exemplary way. Who is it that has to get on with it? Why is it that things are not proceeding? If everything is being done well, why is it not proceeding faster, may I ask?
Sara Vaughan: When I say we need to get on with it, what I mean is the Energy Bill that is currently going through Parliament. It is very important that that continues on the course that it is on and that it gets Royal Assent before the end of this year, so that we can get the secondary legislation in place for next year.

Q10 Chair: What will you then invest? What is so magic in this latest Bill and plan that will make you invest? What will you do? Assume it all goes ahead, go on.
Sara Vaughan: As I said previously, we have a number of projects that are currently under development. If we take one of those, which is an offshore wind farm down in Brighton, Rampion, that is currently potentially going to be under the renewables obligation, or it might be under the CfD regime.

Q11 Chair: CfD?
Sara Vaughan: Sorry, Contracts for Difference, which is the regime that comes under the electricity market reform. We would invest under either of those regimes, because we have confidence both in the existing one and confidence in the new one. By contrast, if we look at fossil fuel generation, as a result of the amount of intermittent generation that is coming on to the system, we expect that the load factor—that is, the time during which fossil fuel plants operate—will reduce quite greatly, so it is quite difficult to put together a business case for building fossil fuel plants at the moment, but it is still necessary, because, as we all know, sometimes the wind doesn't blow and you need the fossil fuel plant to back up the system.
So, one thing that the electricity market reform is bringing into place is a capacity mechanism. We don't know when, because that is one of the questions that we are waiting for the answer to from Government, but on the back of that people—companies like my company—would have the potential to invest in fossil fuel, which is a very difficult decision to make at the moment.

Q12 Jackie Doyle-Price: Are you saying you can't make that decision until after the Energy Bill has gone through and the secondary legislation comes forward, or can we have political intervention before that point? This is a long time scale to wait for certainty.
Sara Vaughan: If you like, it is almost worse than that, because at the moment we are in a situation where we actually don't know exactly what the capacity mechanism is, because that is still under discussion. We don't know when it might come into place, but even worse, we don't actually know whether it is going to come into place. Those are the sorts of decision that we are waiting for in relation to the capacity mechanism.

Q13 Chair: I don't understand—this is my ignorance, because I am not an expert on the matter. Is that capacity mechanism a subsidy of some sort?
Sara Vaughan: If you have plant that is operating on the system, the way it usually receives its remuneration is for the hours that it runs, but if it's sitting there waiting for the wind to drop so that it can come in and run, it is paid for being there. It is the capacity element rather than—

Q14 Chair: So it is a subsidy.
Sara Vaughan: No, it is about trying to make up for the fact that the energy market will no longer give you the reward that you need to justify investment in the plant.

Q15 Chair: You say no, but that is a subsidy. Who pays for it?
Sara Vaughan: I don't see it as a subsidy.

Q16 Chair: Yes, it is a subsidy. One of the problems that we are going to talk about with our other witnesses is that that may help you, but it then hits the affordability of energy prices for consumers.
Sara Vaughan: Actually, the principle is that as the energy income falls, the capacity income rises. So on a net-net basis, there should be very little difference.

Q17 Jackie Doyle-Price: The problem is, the consumer is picking up the tab for all this wind generation, then when the wind doesn't blow, they then have to pick up the tab for gas stations that are only going to be used half the time. That is a massive burden on consumers' bills at a time when energy is getting more and more expensive. You've got to deal with the market we're giving you, but it just seems crazy to me.
Sara Vaughan: What lies behind that is your fundamental belief in whether or not the market should be decarbonised. The Government have taken a decision, which we support, that the market should be decarbonised.

Q18 Fiona Mactaggart: Looking at figure 3 in the Report, there is an enormous expectation of investment in energy. It is almost all private investment, and it is much bigger than anywhere else. Where are you getting the money from?
Chair: Joanne?
Sara Vaughan: Sorry, do you want Joanne to answer the question?

Q19 Chair: Well, we are hoping for an answer about money from pension funds. Are you getting any pension funds money, Sara?
Sara Vaughan: We are not currently getting any pension funds money, but the principle behind the new regime that is being put in place is that it should give other sorts of investors who are not currently in the industry the confidence—
Chair: Who?
Sara Vaughan: Well, like the pension funds, but I can't answer for them, clearly. We want to give them the confidence to come in.

Q20 Fiona Mactaggart: My point goes to how easy it is to raise the funds for this kind of investment. The interesting thing about this Report is that it says that the biggest future investment in infrastructure in energy is overwhelmingly private sector investment. I talk to companies in my constituency that on the whole are not energy companies, but they keep telling me of their difficulties in raising funds to invest in this kind of thing. I want to hear from you, Sara, how easy or hard it is to get it. From our point of view, we can't assume that this is happening. We need you to tell us if it is.
Sara Vaughan: From the perspective of E.ON, we would either use our own funds—so raise them off our own balance sheet—or go into a joint venture with partners. So if you look at our London array offshore wind farm, the largest offshore wind farm in the world, it is 630 MW and is owned in threes by ourselves, by DONG of Denmark, who have come into the UK as a fairly recent investor over the last few years, and by Masdar, which is a sovereign wealth fund from the UAE. They actually came in and took equity in the project, which is quite unusual. Mostly you will find that other investors are more shy of taking the construction risk, as you point out in your Report. Other investors are often more likely to come in once the wind farm or whatever is built and then share in the revenues going forward.

Q21 Fiona Mactaggart: That was an interesting answer, and it told me how you funded things. I am wondering how hard you find it is to fund some of this. It is a good example, but what is your prediction about how easy it is to fund future investment plans?
Sara Vaughan: I think it will be easier if we have the right market framework in place and can encourage people to come into the market on the back of it.

Q22 Ian Swales: I would like to bring in Mr Abel. We had a hearing not so long ago about the offshore transmission assets. I believe your company has invested quite heavily in that sector. Am I right?
Richard Abel: Our sister business. I work in the funds management part of Macquarie, investing the money we have from pension funds in the UK and elsewhere. The advisory business was involved in the offshore—

Q23 Ian Swales: That was a new sector and the Committee had interesting discussions about the risk/reward profile of that sector. I am interested to know from your point of view, as an investor and as a company, how you saw and assessed the risk/reward profile in that area. This was an example of infrastructure—offshore transmission assets. We want to know how it looks from your point of view, because then we can start to judge whether the taxpayer has got a good deal—in other words, the right deal between yourselves and the taxpayers. So can you tell us a bit more about that investment?
Richard Abel: Because I am in a different business, I am not privy to all the details. My understanding of the experience there of my colleagues, who were advising the consortia, is that it was a highly competitive process. It was a clear process run by the regulator and the Department. My colleagues were involved in trying to source financing for the transactions at the most competitive rate, and in order to win for those consortia my understanding is they certainly had to do that as competitively as possible, which clearly translates into, ultimately, lower cost.

Q24 Ian Swales: Was your part of the organisation involved in the actual financing? Are you suggesting it wasn't?
Richard Abel: The sister business, the advisory business, did step into the equity when one of the consortium partners dropped out because it took some time to get to financial close, so it stepped in temporarily and it sold that down afterwards.

Q25 Chair: It sold the whole thing down. One of the things that surprised us about that bit of infrastructure investment was that you took it—you bought it. You won the competition. You got the contract. I think within two months—
Ian Swales: You very quickly on-sold it.
Richard Abel: That was—having stepped in to plug a gap in the consortium that wasn't expected to arise, as is my understanding, in that particular case.

Q26 Ian Swales: But Macquarie are still involved in that consortium, are they?
Richard Abel: They are still involved in advising on deals that haven't yet closed, but they are not involved in the equity.

Q27 Ian Swales: You do not need to give us the exact numbers, but can you tell us how attractive a sale that was? You bought a share of that consortium and then on-sold it. How did you do on the deal?
Richard Abel: I am not privy to the details. I think Macquarie stepped in in that particular case to avoid the consortium dropping out at that late stage. That was the purpose of the transaction.

Q28 Ian Swales: Let us have a ballpark figure. Did you simply get the money back that you had invested, or did you make 10% or 50%? You don't know the answer?
Richard Abel: I don't know the answer to that.

Q29 Ian Swales: Would you let us know, confidentially if you like, what the deal was—what you paid for that part of the consortium that you sold, and what you got for it?
Richard Abel: I will take that question away and give it to my colleagues.

Q30 Ian Swales: There is a reason for asking. We obviously want to see all this infrastructure investment, but we want a proper balance between risk and reward, and one of the concerns we have, looking back over PFI and many other arrangements that the Government have put in place, is that they get that balance wrong; so the early investors can then on-sell a stream of Government money and make a fortune because it was underpriced to start with. In other words, the stream of Government money that goes with the investment was effectively underpriced, so you make a huge capital sum by selling that stream on. That has happened with too many Government projects, and that is why I am asking the question. So if you could let us know, I would be interested.
Richard Abel: If I may comment, I think the key thing in general is to have as competitive a process as possible—that is what is going to drive best value.

Q31 Chair: It can be competitive. If we understand the terms of the competition, we felt on the transmission—interestingly enough, having you here—that the terms of the competition were such that you would be absolutely mad not to compete. It was so much in your interest rather than in the consumer interest. I am not being particularly critical of you; it is just a mad competition.

Q32 Ian Swales: It is what the real risk is that is the real issue. If a thing appears risky and has a high reward, that is one thing, but if the real risk, because it is a public sector project, is very low, people are making a lot of money out of that difference.
Richard Abel: That general point about risk avoidance is absolutely right. To pick up on where investment has taken place and our funds business, we see an ongoing stable, predictable regime in the utilities—the networks in water and in energy. It has allowed a lot of capital investment over time and has allowed the infrastructure companies there to access debt to fund that capital investment more cheaply, because it is stable. Your general point is right.

Q33 Ian Swales: Do you provide capital to companies outside Macquarie, then?
Richard Abel: In the business I work in, which is the infrastructure fund management business, pension funds in the UK and elsewhere, and insurance companies and other investors are giving us money to invest in infrastructure globally in about 100 different infrastructure companies. That includes utilities, and regulated utilities are an attractive sector for pension fund money. Infrastructure is—by its nature, because the capital in pension funds and elsewhere is patient and long-term—typically long-term, capital-intensive and often inflation-linked, like the liabilities of pension funds.

Q34 Chair: So what makes the UK more attractive and what makes it less attractive for you in taking those decisions?
Richard Abel: It is an attractive market, because of the history that I just alluded to. It is a regulated asset-based model that has been in place for a long time. People understand it and it is predictable. Policy certainty, or having as much predictability as possible, is really important in that continuing with EMR or across sectors generally. Also, for international investors, there is the openness of the UK to overseas investment, and infrastructure is an attractive feature of the landscape for them.

Q35 Chair: What does that mean?
Richard Abel: It means that some countries are sometimes more concerned about inward investment by companies based elsewhere.
Chair: I think our Committee would welcome inward investment as long as you pay tax in the UK on the profits.

Q36 Austin Mitchell: Is there, on the disadvantage side, a UK cost premium? Are costs higher, and why? This question goes to Sara Vaughan as well as Mr Abel, but Mr Abel first.
Richard Abel: Looking at the comparison in the study that Infrastructure UK did with the Institution of Civil Engineers, and what you are referring to there in relation to contracting and other costs—from our perspective we are not a contractor, but we observe from being in the market that it is not just about the contracting stage; it is about the planning stage, the design and the early stages of the project. The greater certainty one can have on the reduction in time from deciding to go ahead with a project to getting on with it, is a big factor in the overall project cost.

Q37 Austin Mitchell: Are there more delays in this country?
Richard Abel: Traditionally, with new large-scale infrastructure the planning process has taken quite a long time to get through in many cases.

Q38 Austin Mitchell: Sara Vaughan, it was said that our advanced gas-cooled reactor lost out to pressurised water reactors because of the huge costs of building on site. Are our costs in that area—nuclear—still higher than elsewhere?
Sara Vaughan: I do not know the answer in relation to nuclear, but when we look at which of the countries in which E.ON operates we might invest in, we look at what we think our costs of build are. Obviously, we take into account the fixed costs, the variable costs, our expectation of power prices, and such things as political stability, the regulatory regime, the ease of getting planning and other consents, what returns we think we can make on the project, what the certainty is of those returns and whether they hit or beat our hurdle rate.

Q39 Chair: What is your hurdle rate?
Sara Vaughan: I could not possibly reveal that, I'm afraid.

Q40 Chair: Can you, Mr Abel? What sort of return do you expect on this infrastructure?
Richard Abel: It is very much case by case, depending on where a particular company is, what the nature of the project is and so on.

Q41 Chair: Can you give us a range?
Richard Abel: It would be misleading to give a single figure.

Q42 Chair: A range, I said.
Richard Abel: It really has to be case by case. That is how we look at them.
Chair: You are avoiding an answer.

Q43 Austin Mitchell: If the Government want to get these costs down by around 15%, is that possible?
Richard Abel: With hard work, that is a good target to aim for. It is about all parts of the process, from the early stage of the project, policy, design, all the way through. I know that various workstreams are under way to do that.

Q44 Guto Bebb: On the hurdle rate, and the decision to invest or not to invest, when your company pulled out of the Horizon project in north Wales, you stated that the main reason was because of problems in Germany, not in the UK. Clearly, the message being sent was that the issues were not regulatory in the UK context, but problems in your home market in Germany. My concern is that the Centrica decision yesterday reflects a problem in this market.
Sara Vaughan: When we referred to the fact that the decision was based on problems in Germany, that was in relation to the fact that we were looking at a nuclear project, and nuclear was, clearly, stopped in Germany. That had a number of implications for us. One was financial, but the other was in relation to skills. Previously we had seen the nuclear stations that we built in the UK as being able to benefit from the experience we had from our stations in Germany. The German Government's decision meant that stations in Germany were likely to be near the end of their life by the time the stations in the UK were opening. Couple that with the fact that we made a loss for the first time in the company's history. Capital was shorter than we would like it to be. The return on a nuclear project is out a very long way, because you have a very long time to develop and then construct the project. It was just not a project we were able to stay in at that time.

Q45 Austin Mitchell: You said that the main costs of nuclear, however unpredictable, were going to be less than the costs of wind power, but surely that can't be right. The costs of neither are really known, but as manufacturers such as Siemens establish themselves here and UK developers establish other manufacturing bases, the costs of wind power are going to come down.
Sara Vaughan: For wind power, that is certainly both our hope and our expectation. For our own part, we have taken a challenge to reduce our costs of offshore wind by 40% and our costs of onshore wind by 25%. Certainly yes, I agree with the tenor of your question. That is the expectation.

Q46 Austin Mitchell: Whereas the costs of nuclear are likely to go up.
Sara Vaughan: Again, it depends how well the project is managed.

Q47 Nick Smith: Joanne, will you tell us more about pension funds' willingness to invest in the construction phase? What do you think the biggest barriers are to investment?
Joanne Segars: Perhaps I can take that part of the question first, and look at what the barriers have been for pension funds investing in infrastructure. There is a feeling that pension funds can be like the cavalry riding over the hill—suddenly there is a magic pot of money. At face value, infrastructure should be a good investment and a good asset class for pension funds. It should be long term, and should be able to provide

inflation-linked cash returns, which UK pension funds need to match their inflation-linked liabilities. The problem that pension funds have had is that, generally speaking, that is not what we find in the market. My members tell me that infrastructure is very expensive—far too expensive in terms of fee bases for what they are prepared to pay. The two and 20 model might have come down; it might now be one and 10, but that is still too expensive.

Q48 Nick Smith: High fees, did you say?
Joanne Segars: High fees for infrastructure investment—for the fund's management. They find it—

Q49 Chair: So high fees too?
Joanne Segars: For the management.

Q50 Chair: For the people who are putting the deal together.
Joanne Segars: And they find that there is too high leverage in infrastructure deals.

Q51 Chair: That is why he will not tell us what it is.
Joanne Segars: Infrastructure deals. They also find—it rather goes to Mr Swales' point—that there is not that long-term investment, necessarily. It tends to be built on a "buy it, hold it, flip it" model. So what we want, as pension funds, is a long-term, stable investment that can generate long-term inflation-linked returns. That is why we signed a memorandum of understanding with the Treasury in November 2011, to build a new fund—a pensions infrastructure Platform—which will be built around the needs of pension funds, with low fees, low leverage and for the long term, to generate inflation-linked returns of RPI plus 2% and 5%, so there you have our target investment returns.

Q52 Ian Swales: So cutting out intermediaries is what you want, I think, analysing what you have just said.
Joanne Segars: We are going to build a new infrastructure fund, called the PIP, which will be designed for pension funds by pension funds, built specifically around our needs, to give UK pension funds, for the first time, real collective buying power in the infrastructure market, to be able to put us in the position of dictating rather more to the market what we want as pension funds.

Q53 Chair: Just to pursue the electricity market, you will want certainty, won't you? So you will need guarantees.
Joanne Segars: We will want certainty. We will want to invest for the long term. The energy market and offshore OFTOS are potentially attractive investments.

Q54 Chair: But you want guarantees.
Joanne Segars: We will want some certainty over the longer term. Absolutely.

Q55 Nick Smith: Did you say you wanted between 2% and 5%?
Joanne Segars: RPI plus between 2% and 5%.

Q56 Nick Smith: RPI plus, okay. And when you say, "guarantees", some sort of guarantees on pricing or some Government subsidy, or some tax deal?
Joanne Segars: I do not think we are looking for 'tax deals'. I think we are looking for long-term certainty. We are looking for those long-term cash returns.

Q57 Chair: Underwriting.

Q58 Meg Hillier: Hearing that, and having experienced some of what Sarah is talking about when talking to energy companies, one of the things that is coming through all of this is that political stability is pretty important. I wonder if all of you can answer quickly, saying how that might affect you. Joanne, obviously that will have an impact on the pension funds, because you make the leap at one point, but the change in political vision could come when your pension fund is already committed.

Also, how do we compare with other parts of the world? The German decision: they had been flirting with it for a while, but you clearly had not worried about it, because you carried on. But then this decision came quickly. Do we compare well with other parts of the world? Given that you are businesses and you like taking risk, how certain do you need the political framework to be?
Joanne Segars: From a pension fund perspective, we are not interested in taking risk in this asset class. We want to invest at the lower-risk end. We want infrastructure to be in pension funds' de-risking asset bucket, if you like.

But you are right. Pension funds seek political stability. Pension funds have liabilities stretching out 20, 30, 40, 50 years. So pension funds—

Q59 Meg Hillier: Do you feel you get that in the British system? The danger is that we all want to have party political arguments about things. I paraphrase massively.
Joanne Segars: As we have been developing the Pensions Infrastructure Platform, we have been talking to Government and the Opposition, and I have been struck by the degree of political consensus there is. As we have been fundraising to put together the Pensions infrastructure Platform, what pension funds have said to us is, "It's all very well this lot saying that they want private sector investment and pension fund investment, but what about the next lot and the lot after that?" So absolutely, political stability is something which we would want to see. But I am encouraged—I hope—that we see some consensus across the political divide on this issue.

Q60 Ian Swales: Do you think there is space for grandfathering arrangements? In other words, you agree to do something and then, even if the ground rules change later, you would have a deal agreed at the time. Do you think that ought to be a bigger feature of what we are doing?

Joanne Segars: That certainly would help.

Sara Vaughan: I completely agree. Grandfathering arrangements are important in the energy industry. Political stability is hugely important. I remember your standing up when EMR was introduced and saying that this was not going to be a party political issue and you would seek to support it and "challenge it constructively", I think was the phrase.

Regulatory stability is important as well, though. If I could give a quick example: if we look at levy exemption certificates, which are a particular benefit that was available to combined heat and power stations, the announcement in the 2009 Budget was that those would be in place until 2023, and so investments were made on the back of that expectation, but in the 2012 Budget it was announced that they are being removed from 1 April this year. That is a huge issue for an energy company; it is giving us a financial penalty on an investment that we have already made. That sort of thing does not give you much encouragement to take further investments.

Richard Abel: I would echo the points about grandfathering and regulatory stability. That is what matters to the pension funds that Joanne was talking about, and the others, who—just to reassure you—are actually investing with us in what is a very competitive market for fees. We have UK pension funds, as well as others, committing a total of $8 billion over the past couple of years to invest in infrastructure as an asset class. It is great that UK pension funds are getting together and looking to put more into the sector.

Q61 Chair: I have to say that we have been quite kind to you, but from the consumer's point of view—obviously you won't reveal your profits—energy prices have completely rocketed; that is what Jackie was talking about. They have completely ruddy rocketed, but we do not have the certainty of investment. What I have got out of you is that you want political certainty but you don't get that because we have elections every five years. Although you get consensus now, interestingly enough you just gave an example where a new Government chose to break that down. You want planning ease: well, ever since I have been in politics people have wanted things to get through the planning system more quickly, but it never really happens. You want subsidies, but money is tight. We cannot afford the lights to go off. As Jackie said, it is difficult to raise money anywhere for investment at the moment. I do not quite see a way through that. You can have plans and Bills and Acts and promises, but what is going to make sure that you can deliver the energy we require without ripping off the consumer, which is what consumers feel is happening at present?

Sara Vaughan: Your Report talks about the increase in gas costs since 2004–05, since we have had to import gas. That then leads through into increased prices for consumers. We have also seen network costs rise—they are 10% higher than in—

Q62 Chair: This is you justifying the high costs to consumers.

Sara Vaughan: I am explaining, rather than justifying.

Q63 Chair: What I am trying to say is that at the moment we have uncertainty of supply. I do not think £20 billion is realistic. You are up to £2 billion; maybe we will get to £20 billion.

Joanne Segars: That £20 billion is a long-term figure.

Q64 Chair: By when?

Joanne Segars: I think the Treasury suggested that it might be reached over 10 years, from a range of institutional investors, including—

Q65 Chair: The decision over 10 years, the investment in 30.

Joanne Segars: I would just remind the Committee that £2 billion would double the amount of infrastructure investment currently undertaken by pension funds.

Q66 Chair: I am not blaming you on this.

Joanne Segars: No, I know.

Q67 Chair: Pension funds are there to make sure our pensions are secure.

Joanne Segars: Indeed.

Q68 Chair: It is really about having supply, without ripping off the consumer.

Sara Vaughan: I am sure that Simon Virley will tell you this after we have left, but the scheme for the electricity market reform that has been put in place, with a private law contract between two parties, is designed to help with that point around what happens if the Government changes its mind or there is a change in the regulatory regime. When you have a private law contract, you can always resort to the courts to help to sort that out.

Q69 Chair: You are just in a market with those conditions, making money. I am really fascinated in trying to dig underneath. That is the market you are in, right?

Sara Vaughan: Yes.

Chair: You are in a market where the investments are long term, and there is uncertainty about all those things. All we are looking for primarily is private sector investment. So what is it that is going to make that happen?

Q70 Jackie Doyle-Price: Can I help you out? The point the Chair is making is absolutely spot on. From where I am sitting, there seems to be a fundamental conflict here. We need to have serious long-term investment to make sure we have secure energy supplies. But we also have Governments that come along with a five-year vision, and that is just the matter of the course of politics. So, effectively, you have a lot of activity in the policy area encouraging rapid change that totally changes the parameters of what you do in business. Is there more uncertainty for an energy company investing today than there was 10 years ago?

Sara Vaughan: Yes, I think there is, because if you were looking at investing 10 years ago, you would effectively be weighing up the gas price and the coal price and trying to get a spread between gas and coal so that you weren't completely caught out if gas or coal hit the ceiling. Where we are now, and where we have been since 2009, is that the Government signed up to the 2020 renewables package, which requires us to get more than 30% of our electricity from renewable sources. What that means is that there is a driver to get more renewables into the system. We are not decarbonising in carbon cost order, depending on which is the cheapest technology; we are seeking to hit that target and decarbonise at the same time. That has introduced different factors into the market, which has led to the impact on fossil fuel stations that I talked about earlier.

Obviously, we talked about keeping costs to consumers as low as possible and making things as affordable as possible. In that vein, one element of the EMR package that we really don't agree with is the carbon price floor, which is going to be introduced in April this year. Between now and 2020–21, it is going to add some £18 billion to the total costs of energy in this country, if you assume that the EU ETS stays pretty constant to where it is at the moment.

Q71 Chair: It is a way of trying to shift the direction of where the energy comes from. I know there is disagreement in the room, but the purpose of that is switching.

Sara Vaughan: It will not drive a single bit of investment. What will drive investment are the contracts for difference. The carbon price floor is purely a cost to consumers.

Q72 Austin Mitchell: I think you are making excuses and pretending to be cowering little beasties. The concessions screw up your rate of return. I drop that in as a thought before moving on to the funds.

The Government are desperate to get funding from the private sector for projects. The pension funds have been talked of as investing in PFIs and housing associations to put their money to good use, but are the funds really interested in long-term investment? After all, the fund managers make their living from effectively speculating on increases in share prices. Speculating on the market is what gives them their financial returns as managers. They are not going to be interested in long-term investment at low interest compared with what they can get on the speculative stock market.

Joanne Segars: You describe the dilemma that pension funds have faced in trying to access investments in infrastructure. They have been focused much more on maximising short-term returns, but what we want from pension funds is long-term, steady, inflation-linked cash returns. That is why we have taken the step of setting up this new fund, the Pensions Infrastructure Platform, built by pension funds for pension funds around our needs as long-term investors, not looking to maximise over the shortest possible time and seeking the highest IRR but looking for long-term, steady and pretty low-risk investment with pretty modest returns.

In a sense, that perhaps goes to some of your earlier questions on getting value for consumers by having those long-term, steady and frankly slightly boring investors—in a good way—such as pension funds that are there for the long term and to ensure there is steady ownership of the UK's infrastructure assets. Importantly for our members, they ensure there are good inflation-linked cash returns for pension funds. As the Chair said, they are there to pay pension funds and pay pensions to pensioners, which is what we are about. It is about ensuring that our needs are met and, in the process, helping to meet the Government's needs for new sources of finance to help finance infrastructure. I hope the Pensions Infrastructure Platform will play an important role, starting relatively modestly at £2 billion but hopefully, as more pension funds invest in infrastructure and get used to that asset class, more pension funds will invest.

Q73 Austin Mitchell: It is good to hear that it will be an effective and powerful source of funds, but I presume you will be more interested in the safest possible schemes, such as housing or PFIs for hospitals, on which you get a guaranteed return and ownership.

Joanne Segars: The pension funds that we are talking to through the Pension Infrastructure Platform are looking at lower risk, core infrastructure assets. So, yes, PFI, PF2, social infrastructure, economic infrastructure, transport, energy, but at the low-risk end of the—

Q74 Chair: Anything that has a Government-funded revenue stream?

Joanne Segars: Assets at the low-risk end of the asset class. As I say, we are not looking to shoot the lights out and go for a high return over the short term. This is about long-term, steady investment returns so that we can pay pensioners their inflation-linked pensions.

Amyas Morse: I want to ask Miss Segars quickly, given that you are not just thinking about energy but about the entire infrastructure, how useful has the infrastructure plan been to you? How would you like to see it improved in terms of the inclusion of integrating factors?

Joanne Segars: We are not quite at the stage yet where we are ready to invest. The national infrastructure plan gives us a good idea of what is available. Clearly not all of what we invest in will come through the national infrastructure plan. Other Government developments, including the guarantee scheme, will be helpful to pension funds as investors, which relates to the earlier point about where pension funds might be ready to invest, and under what conditions, in the construction phase. The national infrastructure plan gives us some feel for what the opportunities will be, but we are not quite at that stage where we are ready to invest. I hope that we will be by the end of this year.

Chair: Thank you to all three of you.

Examination of Witnesses

Witnesses: **Steve Gooding**, Director General, Domestic Group, Department for Transport, **Geoffrey Spence**, Chief Executive, Infrastructure UK, HM Treasury, **Simon Virley**, Director General, Energy Markets and Infrastructure, Department of Energy and Climate Change, and **Sharon White**, Director General, Public Spending, HM Treasury, gave evidence.

Q75 Chair: Thank you for being patient. I am going to start with Sharon. The plan isn't a plan, it's a list of 500 projects, with 300 priorities, isn't it?
Sharon White: It is worth trying to clarify what the national infrastructure plan is trying to do, and what it does not do. As you say, it is not a prioritised list, which is one of reasons why we have picked the 40 priority projects that we are really trying to drive. As a previous witness suggested, one of the things that we are trying to do with the NIP is give an indication, particularly to potential investors, of the broad range of projects in the pipeline. Some of those are publicly funded—about 43%, depending on debates about how we count Network Rail. We are trying to give a comprehensive picture, both publicly and privately, of what is available. That is not to say that we are giving absolutely the same degree of attention to all 500 items.

Q76 Chair: Generally, as a Committee, we always welcome better planning. We are on your side on this one, but we want you to improve that planning. You say that the plan is intended to give an indication, but if money is tight, both public money—I am sure that we will come back to that—and given that it is difficult to raise money in the private sector and to entice pensions funds to put their money into the projects, would it not be sensible to do a proper prioritisation within those projects? Would that not help you to deliver your Treasury objective on growth?
Sharon White: Geoffrey will have views because he is much closer to the detail, but one of the ways that we have tried to respond to that is to say that, of the very long list of things that are around, what we are really going to try to focus on are these top 40 priority projects.

Q77 Chair: Forty?
Sharon White: Forty—four zero.

Q78 Chair: Where do the 300 priorities come from? The 300 priorities have been whittled down to 40, have they?
Geoffrey Spence: No, there is a top 40. The 40 include projects and programmes, which takes you to a number of individual projects that exceeds 200. That has always been the case.
Chair: Well, we think that that is a heck of a lot. It is not a proper prioritisation, if it is another way of corralling them together, in effect.
Austin Mitchell: Scatter gun.

Q79 Chair: As Austin says, it feels scatter gun. For example, are there good business cases for all these projects?
Geoffrey Spence: If you take the top 40 projects and programmes, over 70% of those are being funded within the public sector.
Chair: Seventy per cent.?
Geoffrey Spence: Of the top 40, yes. If you include Network Rail as public funding, which we do not, but understand that you do—there is that understandable difference. Within that, of course, if that is the case, that has been prioritised both by Departments and by the Treasury, in terms of that public commitment. I think the rest of the plan, in terms of the far larger number of projects and some of the top 40, is being taken forward by privatised regulated industries. They are being prioritised either by the regulator, whenever he or she settles at the periodic review period what an acceptable level of investment is going forward, or, indeed, sometimes by the companies themselves—if you are a telecoms company bidding for a G4 licence at the moment, you are deciding, because that is a market-based system for whether you want to do that or not.

Q80 Chair: Okay. Let me push you a little further on this, because I still think it is too much. Between 2005–06 and 2011–12, according to the Report you—or we—spent about £210 billion on infrastructure. In the next seven years, you have picked up this figure of £310 billion—so it is seven years, not six years, I accept that. It is also, however, in an environment in which—we have had discussion with Sharon White before—Government public expenditure will be halved. It feels so unrealistic to me, which is why I am pressing you on prioritisation. How realistic is it? How much have we spent of that £310 billion?
Geoffrey Spence: If I take the top 40 for the moment, which is easier for us to handle because they are more within the public sector, about 20% of those projects are currently being built or have been completed. In 2014–15, about 50% will actually be under construction or will have been completed.

Q81 Chair: You are saying, "Have confidence", so give me the figures. How much have we spent? How much is contractually committed?
Geoffrey Spence: If you take infrastructure as a total, which is the private spend as well as the public spend, I will have to double check the figure but I think we have spent just over about £30 billion a year at the moment in the UK.

Q82 Chair: I am thinking about the 500 projects in your plan.
Geoffrey Spence: Yes.

Q83 Chair: So I am not just thinking of a private company building a new factory, or investment in the motor industry, let us say, which we have welcomed.
Geoffrey Spence: That is the amount of money that the water companies would be spending, under their regulated framework, the same in terms of the public spending going on—let us say the things being spent on Crossrail at the moment. The scale of investment that we see every year in infrastructure in the UK is actually reasonably high and, in fact, is higher than it

has historically been—that is an annual spend. So there is a bit of a risk of looking at these very large numbers such as £310 billion and thinking that they are unachievable, when actually we spend quite a lot annually if we put the public and private sectors together.

Q84 Chair: You are spending £30 billion a year at the moment.
Sharon White: Between 2010 and 2012, we reckon on spending about £33 billion a year.

Q85 Chair: You have spent or you are committed to?
Sharon White: It will be based on our estimated out-turn for 2012.

Q86 Nick Smith: Is that £10 billion a year? Is that what you are saying?
Sharon White: No, it is about £33 billion a year. Between 2005 and 2010, the comparable figure was about £29 billion a year. To take the Chair's point, even within—

Q87 Chair: Is that cash or real?
Sharon White: That is a very good question. I do not know the answer to that.
Geoffrey Spence: I think it is cash.

Q88 Chair: So it is about the same in real?
Sharon White: Broadly. But the point that I would make is that within the public constraint—investment spending has inevitably taken a big hit in the SR10, as we said in our session with Nick on the spending round—we have tried to prioritise and protect the most economically beneficial investments. As you know from the autumn statement, we went back to Departments and said, "Actually, we're going to take out another chunk of your current spending—a 1% or 2% slice—in order to try to put another slug into infrastructure investment." There are other areas of our capital budgets which have taken a much bigger share of the strain since the coalition Government came in, but relatively speaking, infrastructure has been protected.

Q89 Fiona Mactaggart: I am a bit confused. When you started speaking, you said we need to look at the money that we can control, which is in public spending. If I look at figure 2 of the Report, it says what we have spent so far and has the various sectors on which we have spent it, and figure 3 looks forward. The problem is that what figure 2 does is slightly different from what figure 3 does, because figure 3 tells us how much of the planned investment will be private investment, in contrast with public-private or public. Public-private is perhaps our argument about National Rail, looking at that figure.
Nevertheless, if you look at figure 3, the overwhelmingly large part of the investment which is described in the national infrastructure plan is private investment. What I think I have been hearing from you is, "We cannot really influence that, so we can influence this bit." Have I misunderstood you?
Geoffrey Spence: No, I think that was the debate about prioritisation and the focus that we got on the top 40. We have prioritised that, because quite a lot of that is public spending, which we naturally do. When we look at the energy chart that you are looking at, an awful lot of that is within the larger number of projects—in total, 550—which happens within the privatised space. They tend to be a bit smaller and less under our control as projects, because they may be decisions for the regulator and the investor.
Many of those projects will not have difficulty going ahead and being financed. If you look at the water sector, any of the projects that they need to take forward—with one exception, which is the sewer here in London—will be taken forward within corporate balance sheets without any difficulty.

Q90 Fiona Mactaggart: But what we have been hearing from these companies is not just that they might or might not have difficulty raising investment, but that there are policy frameworks, which make that possible or not. I am concerned that the Treasury owns this space but does not write those policy frameworks. I am anxious about whether delivery Departments are structuring their policies and so on in a way which promotes this infrastructure investment. I cannot quite see, reading this Report, what the machinery is to make that happen, apart from good will and hope: they want to make this stuff work. If you have a national infrastructure plan, don't you need some mechanism to ensure that policy Departments do that? I cannot see it. It might simply be because I have not read all the detail, or it might be because it is not there. I hope that the answer is not the latter.
Sharon White: Can I talk a bit about that, without wanting to be overly bureaucratic and talk about lots of Government structure? The point that came up in the earlier session which is really important was about policy and political stability. As the Chair said, you can never fully work these things away. That is the nature of a democracy. However, thinking about the discussions that I, Simon, Steve and others inside IUK have, we are trying to develop a number of mechanisms across Government to at least ensure that there is more cohesion between the Treasury and the delivery Departments. For example, the Chief Secretary now chairs an infrastructure committee. It is almost unheard of for any Minister worrying about public spending to be so involved in trying to ensure that the detailed delivery—the budgets and what happens on the ground—actually adds up.
You will know from the previous session that there is the major projects review group, which David Pitchford and I jointly chair. So for Crossrail and a number of these big projects that are part of the top 40, where you have big public money involved, we will provide support, scrutiny and challenge functions. We have had regular discussions with Steve in his previous role as the SR for High Speed 2 about where we are on the budgets, where we are on the cost review, taking cost out, and where we are in terms of future risk. Similarly, Simon, Geoffrey and I have talked about the construction of the new nuclear plant at Hinkley. So we are trying to develop mechanisms across Government to ensure at official level and at ministerial level that investors will not get different

stories whether they talk to the Treasury or the key delivery Departments.

Q91 Chair: Sharon, this is what Fiona was getting at and it is really important. You have talked about trying to drive public sector investment projects in a better way. We welcome that, and I am sure we will come back to it. However, most of the investment is going to be private sector investment, so if there is a shortfall, what lever do you pull?
Simon Virley: Can I come in on this point? Something that has not been referred to is the market with regard to energy investment. So yes, Government policy has a major role to play, as we heard from your witness from E.ON, in terms of shaping that market, but ultimately the scale of energy investment is related to the size of the economy, and if we have had a big recession, we don't get as much in.

Q92 Chair: Listen, if the lights go off, your Minister will get the blame and the economy will shrink.
Simon Virley: That is well understood.
Chair: So it is no good saying it's the market. That is why I asked what lever you can pull.
Simon Virley: That is why we are taking the electricity market reforms through Parliament at the moment.

Q93 Chair: What lever do you pull?
Simon Virley: We pull the capacity mechanism lever, which is part of the electricity market reforms.

Q94 Chair: You subsidise. You put in a subsidy, which then falls on the consumer.
Simon Virley: The impact assessment on the capacity mechanism that we have published shows that you could avoid very peaky prices if you actually paid for certain availability as well as for delivered energy.

Q95 Chair: No, you start with higher prices and they remain higher for longer, that is how I read that.
Simon Virley: It is not as clear-cut as just the consumer losing out. Does the consumer want to pay extremely high prices at times of scarcity? I want to stress that some of the projects in the energy space, which, as you see here, are dominated by private sector investments, will of course be a function of the size of the economy and the demand for energy.

Q96 Chair: Of course that is true, but what you have actually told us, which is really important, is that your only lever if the private sector fails is to increase the public subsidy. That is at a time when we are trying to cut the deficit and you are cutting capital investment in your budget plans. You cannot square that circle.
Sharon White: This is tricky. Another factor that we have not talked about is the guarantees that Ministers announced last year. There are £40 billion worth of guarantees, not on Government balance sheets, but there as a sort of last resort mechanism to try to shore up private sector investment where there are concerns around its fragility. As you will know, on the Northern line extension through to Battersea, where there have been concerns about the private sector's stability, there are active discussions. There is a £1 billion guarantee there.

Q97 Chair: We want to come back to that. Just one final question on this, then I will bring Ian in. Your only lever is more public money.
Fiona Mactaggart: Or more money from the public, because people are paying higher prices.
Jackie Doyle-Price: Or ripping off harmless consumers, because we are talking about the demand being high during the working day, and the only consumers who use electricity during that time are people who do not work or are living on pensions. So there is a double whammy here for consumers, isn't there?
Simon Virley: We published estimates of what we think the impact of energy policy is on bills. Those are updated regularly, but it is worth stressing that the main reason why energy bills have gone up over the past few years is world energy prices. There is very little that we can do either about—

Q98 Jackie Doyle-Price: Because of the move towards decarbonisation, which the consumer is having to pay for. I am quite sure that consumers would not have been quite so relaxed about tackling climate change if they knew how much it was going to cost them.
Simon Virley: Two thirds of the increase in energy bills since 2005 has come from world energy prices. It is the gas price that has been the main driver as to why people's energy bills have gone up over the past six or seven years.
Jackie Doyle-Price: Because the coal has been falling off a cliff. It's got to come from somewhere.

Q99 Austin Mitchell: In figure 1, private investment shoots up throughout the period of the Labour Government. How much of that is private? Where do housing associations and PFIs come? Do they come under the private investment sector or do they come in the public investment sector?
Geoffrey Spence: Mainly, PFI transactions are in what I call social infrastructure, and therefore do not appear here as economic infrastructure. There is a little bit of overlap because, for example, some roads have had PFI-style contracts that would appear in this chart, but actually it is relatively small to the total.

Q100 Austin Mitchell: And housing associations?
Geoffrey Spence: Housing associations would not appear in this either, because that would be classed as social infrastructure.

Q101 Chair: May I ask one final question before I go to Ian? We have established that either the consumers or the taxpayers—the consumers both ways—will pick up the tab if you cannot encourage private sector investment. Sharon, everybody says that infrastructure investment is absolutely key for growth, so would you wear that burden on the consumer or the taxpayer to achieve the growth? Is that where we are going?
Sharon White: You are having to balance some very difficult factors. It was interesting to see the LSE

Growth Commission last week, which is addressing very similar themes. Essentially, with our economic ministry hat on, we would definitely like to see an expansion in economic infrastructure over the period of time. Currently in the Government's plans, the assumptions for capital growth is going to be slightly more generous at the beginning of the next Parliament—

Q102 Chair: £6 billion.
Sharon White:—than it has been, which basically means that it is just flat in real terms.
The dilemma we have is that, in order to accelerate that further, for example, even if we were going to keep capital investment as a share of GDP—it is currently 2.5%, due to come down a bit—somebody has got to pay. As you say, that is either falling on the private sector, increasingly with guarantees potentially shoring up the fact that debt finance is so difficult to find, or it is the public sector, where we are having to weigh difficult issues about who bears the burden. Is it the general taxpayer? Is it individual consumers, with concerns about how you ensure that the most vulnerable bear the greatest protection? There are generic ways of doing that, which the Government have done. On the fuel duty escalator side there are targeted ways, such as some of the warm homes initiatives that Simon drives or winter fuel payments and so on for pensioners. But it is not a free good. That is essentially the dilemma.
From the Treasury's point of view, we are concerned both about the distributional effects, particularly what this means for the bottom fifth and two fifths quintiles, and also, to be frank, about what shooting prices mean in terms of economic growth. Some of the estimates as to why the economy is still 6% smaller than before the economic crisis attribute that to the rise in bills, and the impact that has had on living standards and consumer spending. We are concerned about the macro impacts, but we are also very concerned distributionally about what this means—

Q103 Chair: Rock and a hard place.
Sharon White: It is a rock and a hard place.

Q104 Ian Swales: We are talking about infrastructure planning. I would like to ask Mr Virley some questions. The world of DECC seems to get ever more complicated. Whether it is the 47 variants of the renewable options, whether it is the green deal, the carbon floor or whatever, you now need a postgraduate level of education to even understand it. I am just wondering whether you have an overall plan of what you want our energy infrastructure to look like, and if so, are all these mechanisms plus the market going to get us there? If not, what are we going to do about it? I am talking about the balance of how it looks.
Simon Virley: The Government's position is that they want a diverse and secure energy mix. "Don't put all your eggs in one basket" would be a summary of the Government's policy.

Q105 Ian Swales: Do you have any idea of how many baskets and how many eggs in each basket, to use your analogy, you are aiming for?
Simon Virley: The principle that underlies electricity market reform is essentially to get the best deal for the country and to get the lowest cost for consumers. We have published estimates as to what we think electricity market reform can save the country in terms of costs to consumers and lower bills. The way to do that is to try to maximise competition in the market—bringing in new entrants. We are very keen to work with new players coming into the market: we heard earlier a reference to sovereign wealth funds; we will potentially get pension funds investing; and there are new entrants in terms of companies such as Hitachi coming into the nuclear world. That is the basis on which we want to generate a competitive, diverse market and to maximise the competition between technology types. We do not have a plan that says that it will be *x*% of this and *y*% of that, with the exception of the renewables target, which we have to meet.

Q106 Chair: How much of the £110 billion you identified in 2011 as needing to be delivered by 2020 have you spent?
Simon Virley: Investment in power and gas reached a 20-year high at £10 billion in 2011.

Q107 Chair: You have spent £10 billion out of the £110 billion that you identified you need to spend by 2020.
Simon Virley: In 2011, the total was £10 billion, yes.

Q108 Chair: And in 2012?
Simon Virley: We do not have the figure yet.

Q109 Chair: But you are miles off your target.
Simon Virley: No. Both the chart in the NAO Report and, indeed, the external survey that I have just referred to—the one carried out by Ernst & Young—suggest that investment in the energy sector is actually rising.

Q110 Chair: They "suggest"—we want to know what is really happening, not the jargon about what we all hope will happen and that we have all heard for years.
Simon Virley: I gave you the latest published figure, which is £10 billion in 2011.

Q111 Chair: What was it in 2010?
Simon Virley: I do not have that figure, but it will be comparable with the charts—in other words, profile-wise, it is similar to figure 3 that I think is in your Report.

Q112 Chair: I cannot see from that. I do not know whether Mr Spence can. I cannot for the life of me see how you are going to get from that to the figure—it is a DECC figure—for that level of investment by 2020.
Simon Virley: That was an annual figure of £10 billion—

Q113 Chair: Yes, but it is not over 10 years: 2020 is seven years away.
Simon Virley: Yes, so we need to raise the rate of capital investment if we are going to meet our energy needs.

Q114 Ian Swales: May I build on that? One of the Committee's concerns is that, in that dash for investment, we may use taxpayers' money to incentivise private investment in a way that is excessive on some projects and needs to be made excessive to get people interested. In my earlier example about offshore transmission assets, we are worried ultimately at the lack of competition that appeared to happen in that market. The suspicion is that somebody has been able to take a Government incentive and capitalise it very quickly.
This is something that the Committee keeps coming back to: if you guarantee a stream of funding of some sort, people do not hang around for 20 years; they capitalise it straight away. I use the example of the solar panels on my roof. I reckon that I could get double what I paid for them if I capitalised it now. In one year, I could have doubled my money by capitalising the future stream. One of our big concerns is that the deals you keep doing are not giving the taxpayer the potential reward from those kind of arrangements. How are you going to ensure that the taxpayer, having borne the risk in a lot of projects, gets a fair share of the reward, particularly in those onward sales deals?
Simon Virley: Essentially, it comes back to maximising competition both in the energy market itself and between technologies. In a sense, we are running a technology race, and the cheapest low-carbon technologies will gain the biggest market share. That is why we are not promising that there will be *x* GW of nuclear by 2030 or *y* GW of carbon capture and storage. We are basically saying to all those sectors, including solar, "You get your costs down and there is a bigger market share," so it is about competitive forces.
May I add one point? To pick up the comments made earlier by the representative of the pension and infrastructure funds, if we provide certainty of returns we can actually lower the cost of capital, and if we lower the cost of capital, that is good for investors, but it is also good for consumers.

Q115 Ian Swales: I wanted to pick up that point because it is a constituency issue for me, as well as for the country. In the previous session, the representative from E.ON mentioned the combined heat and power change, which took place in 2012. A company in my constituency, Semco, were absolutely devastated that the rules had suddenly changed. They had made a huge capital investment based on a regime that went to 2023. DECC suddenly changed the regime, and Semco is now staring at a huge financial loss. How on earth can you talk to private sector companies like that one with any confidence, when you are prepared to do things like that?
Simon Virley: It was a decision taken by the Chancellor in the Budget, but obviously it was really for fiscal reasons to save the Revenue support that was going to CHP.

Q116 Ian Swales: The Chancellor did not suddenly guess, "I know, I'll go and look at that particular combined heat and power scheme that was launched a few years ago." There is no way. DECC spoke to him. They must have done. How on earth could the Chancellor guess that that was a thing he might go and raise some money from?
Simon Virley: There is a fiscal saving, which was the main reason for that policy change. The system that we are moving to, in terms of the Bill that is going through Parliament at the moment, is essentially one as you heard earlier from the witness.

Q117 Chair: Everybody says you need stability. You put forward a cut, which created instability. Is that the point, Ian?

Q118 Ian Swales: Absolutely. I do not believe that the Chancellor decided to take money from that in order to spend it on social housing or something. This has all been part of some deal with the Department of Energy and Climate Change. It must have been.
Simon Virley: The point I was going on to make was that, as you heard earlier from the witness from E.ON, we are moving to a system where low-carbon generation will be supported by long-term contracts that will be grandfathered.

Q119 Chair: How can anyone have confidence in that?
Simon Virley: It will provide legal certainty.

Q120 Ian Swales: What are you going to do about those companies who have been caught up in that policy change? There aren't many, but for each of them it is disastrous, E.ON being another one.
Simon Virley: We continue to keep under review the support that is needed for different technologies. Work is under way to look at the future of combined heat and power in the market, both in the heat market and electricity.

Q121 Ian Swales: But the point is that you have set a ratio, people have invested tens of millions of pounds in new plant, and now you have pulled the rug from under them. Do you not see that that is ultimately a bad deal for the taxpayer? You put a risk premium into the market for everybody who is thinking about investing in the latest renewable scheme, because they have seen that you can change the ground rules in a couple of years. Do you not see that that is a problem?
Simon Virley: The system that we are putting place in terms of the electricity market reform will be—

Q122 Chair: Always the future, Mr Virley. Always the future. We are judging you on your actions, not on your promises.
Simon Virley: It is the system of long-term contracts, backed up by law.

Q123 Ian Swales: This is the latest system of long-term contracts, which replaces the previous system. Who is to say that, in two years' time, you are not coming out with a new system of long-term contracts?

Q124 Jackie Doyle-Price: Ian has just illustrated that you are talking about the need to set long-term certainty to encourage investment, but history tells potential investors that there can be no certainty. This is really where I want to ask my questions to you, Sharon. Ultimately, the Department of Energy and Climate Change has got its job to do. To be frank, it is balancing two conflicting objectives, which is decarbonising and generating sufficient energy, and in an affordable way. From the perspective of the Treasury, whose job is to make sure that the economy keeps going, the economy remains competitive and the taxpayer doesn't get ripped off, don't you think that the Treasury could be better at challenging exactly what is going on in that Department from that perspective?
Sharon White: The way in which these decisions are taken is that the Chancellor is very much at the forefront and centre with the Secretary of State for Energy and Climate Change, when these big decisions on the policy framework are decided.

Q125 Chair: Was it your idea or his idea to change the scheme?
Sharon White: I don't know the details.

Q126 Chair: Do you know, Mr Spence?
Geoffrey Spence: No, I don't.

Q127 Ian Swales: Maybe Mr Virley can tell us.

Q128 Chair: Whose idea was it? Your idea or the Treasury's?
Simon Virley: I have set out the reasons why the Government changed the policy. It was because it was a fiscal measure.

Q129 Chair: I know that you did it as a cut. I understand that. Was it your idea or did it come from the Treasury?
Simon Virley: I am not in a position to comment on that, but the explanation for it was to save money.

Q130 Chair: You are in a position because we are asking you.

Q131 Jackie Doyle-Price: It was a short-term fiscal measure that has been very damaging to investment. The infrastructure plan that the Treasury published was very frank about the challenges we face in terms of energy supply. It just seems very odd that the Treasury really is not on top of this and making sure that we are not having unintended consequences from decisions that might have to be made in a fiscal sense.
Sharon White: I do not know the detail about the precise measure from the Budget. Obviously, with any Budget, you are always balancing competing issues and competing pressures. Whether that is, on the one hand, trying to make further progress on deficit reduction—we still have a deficit equivalent to that of the US and higher than Greece, Spain and Portugal—

Q132 Chair: We know all that.
Sharon White: That, versus some of the deleterious effects that you may have from measures that investors or consumers may have been relying on. As I said, I do not know the details of this precise measure.

Q133 Jackie Doyle-Price: I'll put it a bit more rudely then. We are seeing the Treasury behaving like very good bookkeepers but bad economists. You put together the Report which, as I say, is very frank about the macro-economic challenges of energy supply, but it is not really joining up the Treasury deficit. It comes back to what you were saying earlier when you were talking about the spending on transport. The Treasury can influence that very easily, because the Treasury is writing the cheques.
Figure 3 tells us that we are relying on private investment to make sure that we will have enough energy capacity, yet there we have a decision made for fiscal reasons, which will clearly have an impact on the behaviour of private investors in a marketplace. That must have been factored in, and if it wasn't, the Treasury really must get its act together.
Sharon White: I want to make a broader point. Apologies that I do not know the details of the measure, but I know Budget processes, and in Budget processes you are weighing up conflicting issues with winners and losers, sometimes the fiscal pressure dominates.
On the bigger question of where the Treasury is in the discussions around energy reform, energy infrastructure and investment, that is clearly more than a partnership between the Treasury, DECC and other Departments because the reliance on this investment is an electricity market reform, which is essentially a tax or a fiscal measure. The Treasury has been very closed involved in it; it has been an area of, I won't say heated debate, but there has been a lot of debate, because you are absolutely balancing affordability and value for money, or trying to ensure that consumers are able to face a fair price, particularly in investments that are incredibly innovative. The discussions that we are currently having around nuclear and EMR—nobody has built a nuclear power station without public subsidy, but based on a levy framework. Those are areas where these policies were not signed up unless the Treasury was happy.

Q134 Jackie Doyle-Price: That is all fine, but the longer you talk about it, the more time it will take before someone brings a concrete proposal. In the meantime, we have measures that could be quick wins. They could be investment in gas. We have applications that have been processed. They have all the permits. But no one will start spending that money until there is certainty.
It comes back to Ian's example. Companies have made investments. We are talking about companies that you are expecting to invest in other methods of generation who have had their fingers burnt because all of a sudden the regime has been taken away from

them and what looked like a good long-term investment is now a waste of money.

Q135 Ian Swales: By the way, that company is based in Singapore. People are sat on the other side of the world watching this.

Q136 Jackie Doyle-Price: These are all global companies; npower owes nothing to us. It is German. E.ON is French. Let's get real here. We are dealing with private investors. If you are expecting them to invest billions of pounds so that we can keep the lights on, you have to realise that they are not in it for charity. They need the certainty for that investment.
Simon Virley: May I comment on the point about gas investment? We are actually seeing some gas investments going ahead. The Carrington plant, for example, reached financial close in the fourth quarter of last year. That is a gas-fired power station. It will help with our security of supply in the middle of this decade. So some investors are going ahead. What we have said as a Government is that if there were to be payments under the capacity mechanism, if you go ahead now, you will be eligible for those payments. That is not as perfect as saying it will be *x* pounds per megawatt-hour, but it is giving investors as much certainty as we can. There are about 15 GW of gas-fired power stations that have been consented, that are ready to go forward, but nobody is taking them forward. Why? Because the economics of gas doesn't work at the moment. Why? Because the economy has shrunk by about 15% from when they started planning those power stations. That is the main reason. In the gas generation strategy we published just before Christmas, we set out the analysis of that. We have to look at energy demand in the context of the scale of the economy and the demand for energy. It is not simply a plan that we have to see through irrespective.

Q137 Jackie Doyle-Price: How much power are you buying from overseas now?
Simon Virley: Interconnection in total adds up to about 4 GW at peak capacity, which is a very small fraction of total generating capacity in the United Kingdom, which is about 90.

Q138 Jackie Doyle-Price: That is a very bureaucratic way of answering the question. When you are buying power from overseas now, at peak supply, what proportion of that use is it—bearing in mind that this is still while we have some of our coal-fired stations going?
Simon Virley: I may be misunderstanding the question, but I was answering it in terms of the maximum capacity of any interconnection, that is, electricity coming from abroad, being about 4 GW, and total generating capacity in the United Kingdom being about 90 GW. It is a very small fraction at the moment.

Q139 Justin Tomlinson: And what are we expecting to happen over the next 10 years with that proportion?
Simon Virley: In interconnection? A number of interconnectors are currently being planned, with Ireland, with Norway, with Belgium. We would expect the amount of interconnection to increase, but it will still be a small fraction of the total generating capacity, and indeed of the electricity need in the United Kingdom.

Q140 Jackie Doyle-Price: We are buyers from France and Holland at the moment—is that right?
Simon Virley: Well, the interconnectors work both ways, and it is a market-based mechanism, so it depends which way the prices are.

Q141 Jackie Doyle-Price: So when the wind blows, they will be buying ours?
Simon Virley: It could be mutually advantageous, of course: if Norway's got lots of hydro, when the wind isn't blowing it might be a good thing that we have access to cheap Norwegian hydro.
Amyas Morse: To be clear, if I have this right, it is inevitably true that if you want to attract capital in the long term, particularly capital that wants relatively low risk and a certain rate of return, that can only be done by, in some shape or form, putting the public sector on risk. You either pay more or accept risk, some of which, over the long-term probability, will fall on the public sector, otherwise it would not be worth anything. In the current low-growth environment, if you want to bring on more generation projects, that is going to drive you, by one means or another, into accepting more risk or more commitments to income support from the Government, simply because, as you have said, people won't make these decisions right now based on an ordinary current business case. Is that reasonable? I don't think I am saying anything very different from what you are saying. If you want to use infrastructure investment to drive growth at the moment, you are going to have to rely on the fact that the people who can put the guarantees in place to get things started are actually the Government. Is that right?
Simon Virley: Yes, I think that is true, to the extent that we can influence the outcome to the energy market, though I do want to stress again that it is still a market, with private actors reflecting and responding to a framework. But I agree with your proposition that, essentially, the more certainty we can provide—which essentially comes back to where the money is coming from—and the lower the cost of capital, the better that is for investors and the cheaper it is for consumers. That central argument I would very much support.
Amyas Morse: Whereas if the economy was growing more strongly—which we all hope it will be—investors could start making assumptions about what the minimum level of growth is that they are prepared to assume without necessarily having a Government guarantee or Government support. Is that also reasonable? It is not the case where we are at at the moment, I don't think.
Simon Virley: Yes; if you have very strong economic growth, you have generally higher prices, because there will be more demand for energy, so that will then incentivise the supplier.

Q142 Austin Mitchell: As a subsidiary question to Mr Virley, what allowance is made, or what long-term plans are made, for fracking?
Simon Virley: The Government has said that it is content for fracking to go ahead, subject to safer environmental standards and new procedures and checks being in place, and in DECC we are setting up an Office of Unconventional Gas to provide a single point of contact for the industry. That announcement was made before Christmas, and we expect Cuadrilla to restart their operations near Blackpool—

Q143 Austin Mitchell: Yes, but nothing is set aside for it.
Simon Virley: It is for the market to come forward with proposals, and obviously we would then consider them against the new standards that we have set out.

Q144 Austin Mitchell: I want to talk now to Mr Gooding, who has been sitting there in his quiet lay-by, watching the passing traffic. I wonder how far you and Network Rail have got with the investment plans you have for up to 2014.
Steve Gooding: Up to 2014?

Q145 Austin Mitchell: Are you on track to deliver them?
Steve Gooding: They are well on track to deliver all the investment plans that are programmed for the current control period. As you know, the programme is set out in five-year tranches. Were you thinking of particular schemes? Investments are going ahead; we have got—

Q146 Chair: When will you first dig a hole for HS2 under your current plans? When is the first digger going to be on site?
Steve Gooding: I do not think the first digger will be on site until about 2018, for HS2.

Q147 Chair: 2018? That is the most optimistic current estimate?
Steve Gooding: The start on site will depend on the passage of the hybrid Bill and the awarding of the contracts.

Q148 Chair: I understand all that. So that does not help use infrastructure investment to stimulate growth, does it?
Steve Gooding: It helps, I think, having—
Chair: I am really looking at Mr Spence.
Geoffrey Spence: Growth from infrastructure comes in two ways. There is the short-term stimulus of a construction project, in terms of that HS2 would not help, but what you do get from infrastructure is medium-term competitiveness, and I think that is as important, if not more so, in terms of cumulative impact.

Q149 Austin Mitchell: It is a very long-term white elephant. I have given up hope of being on Grimsby station as a Member to welcome the first high-speed train when it arrives there. How much is high-speed rail going to carve out from the investment needs of the traditional railways? Is it not going to starve them of investment?
Steve Gooding: We do not think it will, but I wanted to hark back to the Chair's question first—

Q150 Austin Mitchell: Do you not think so?
Steve Gooding: We are talking about public spending decisions that will be taken some years down the way. For something of the scale of High Speed 2, which you have discussed here before, there is a discussion about what the state can afford which we will need to have with our colleagues in the Treasury. Ultimately the Chancellor will take a judgment on this, but all the Government is being clear about is that it does not see High Speed 2 as the be-all and end-all of all transport investment.

Q151 Austin Mitchell: But it will drain money away from the real need, which is investment in the railways.
Steve Gooding: It will be a big new project which will augment the national railway network. It will follow on from and dovetail with the very significant investments that are going ahead now, for example the boring of the Crossrail tunnels, which is happening in real time now. Around the time that expenditure is tailing off on Crossrail we will see expenditure starting to ramp up—if Parliament agrees—on High Speed 2.

Q152 Chair: How do you decide, in your Department, for example to prioritise road against rail? My view is very much that there is insufficient prioritisation in the process. How do you decide, in your bit of the infrastructure? What factors do you regard?
Steve Gooding: We take a variety of things into account, and hopefully we will be able to set this out more clearly in the transport strategy that will come out shortly. The cycles that investment decisions are taken on are not exactly the same, but the considerations that Ministers must have in mind concern the various roles the different modes play. For example, if we think about the ability of people to get around the country, or goods to get around the country, what we weigh up is how much might go by rail and how much might go by road, the capacities of the different networks and the options for enhancing that capacity.

Q153 Chair: How do you decide? You have not really answered the question. So you look at people's current journeys? You have a pot of money, but how do you decide to put more into rail or more into road? What are the three or four factors? Do you look at economic growth?
Steve Gooding: Top of the list at the moment is definitely whether this is going to be an investment which supports growth. We are looking at where the demand seems as though it will be greatest. We are looking at where the capacity can be delivered and where there are schemes that can be implemented. We are always looking over time at what can be done swiftly, as you imply, and what we need to be planning for in the longer term.

Q154 Austin Mitchell: How far are you going to be choking off demand by fare increases? Fares have increased exorbitantly in the last few years. It is 7% this year. Is that really a way of choking off demand for the railways?
Steve Gooding: The Government have sought to tune back on fare increases by reversing out of the plans that have been there for an overall RPI+3 increase. We have actually seen continuing and extraordinarily strong growth, despite what has been happening with fares. We have seen significant growth both in long-distance and other rail services that, we are projecting, looks set to continue. We are not actually seeing that being choked off at the moment.

Q155 Austin Mitchell: Will, for instance, the investment needs particularly of the east coast main line, which is the one that I am interested in, be starved by the money channelled into this white elephant, HS2?
Steve Gooding: The investment plans for the east coast main line are scheduled for the next Network Rail control period, which kicks off in a year or so. Network Rail is already working on the plans for the east coast main line now, and we already have the contract in place to get some of the new rolling stock for that line. Just thinking of the way that these things dovetail, the work to the east coast should largely have been completed by the time we are actually getting the diggers on the ground for High Speed 2.

Q156 Austin Mitchell: How far are you looking at tolls to expand the road programme—private enterprise road building on tolls?
Steve Gooding: One of the things that the Government have asked us to look at is precisely that. On the scheme to enhance the A14, we are looking at what can be done there by way of financing some of the investment by tolling. It is frankly extremely difficult to make these schemes stand up as financially viable purely through tolling. We have a history of doing that in this country on things like tolled crossings, for example the Dartford crossing. I don't think that any of us thinks that an A14 is fundable through tolling, but we think that tolling could play a part there. That is something that my colleagues are working on in real time now for decisions later this year.

Q157 Austin Mitchell: So you envisage little bits like the M6 toll, but you are not envisaging any major new road building based on tolls.
Steve Gooding: The Prime Minister set us a challenge last year to look at options for getting to a higher and sustained level of investment for the road network, and did not rule out tolling for genuinely new capacity in that context. That is something that we will be reporting on to the Prime Minister shortly.

Q158 Jackie Doyle-Price: The Chancellor last year announced support for a new crossing at Silvertown for the Mayor of London to construct with the support of investment from a pension fund. That is now over a year. What is the progress with that? Are you able to attract that kind of finance?
Steve Gooding: I am afraid that I am not completely up to speed on the Transport for London scheme at the moment. It is a challenge to attract private finance unless, as we have heard from the earlier witnesses today, there is a fairly stable and predictable return to be had. We have had some examples through previous private finance deals, which the Committee has—

Q159 Chair: Criticised. The M25 road widening sticks in my craw.
Steve Gooding:—which there are a variety of views about, but they are there. We learn from those. We hope to be able to attract more private finance looking ahead.

Q160 Jackie Doyle-Price: And you are consulting on a new lower Thames crossing. I have to say that I am an anorak on this subject, because my constituency is at the north end of the Dartford crossing. I am assuming you are looking at that to be funded by tolling. Would you be looking for private investment there, as well?
Steve Gooding: Because we have not got a scheme there, the Government are consulting on various options for where a crossing might go. It is a bit early to say, but I would expect, just looking at the history of the crossings there, that the option the Government would wish us to pursue would be a privately financed tolled option—quite possibly, like the Severn crossing where we bundled together the existing tunnels and bridge with a new crossing, depending on exactly where it might go.

Q161 Chair: I want to come back to Sharon White and Geoffrey Spence with some issues that they need to lead on. We have just been talking about tolling. We have talked about subsidies to the electricity market, which you have said are difficult. What I found particularly unacceptable in the Report was that you had given up on looking at affordability in the consideration of this infrastructure investment. I know that it is hard and that it may not be 100% accurate, but it seems utterly critical—whether it is in the energy market or indeed transport infrastructure—that we have a view on affordability before a decision is taken.
Sharon White: It is not quite true to say that we have given up on doing an affordability framework.

Q162 Chair: I cannot remember which page, but—
Sharon White: But you are right. We had proposed coming forward with it before now. We look at affordability within sectors in infrastructure. Geoffrey can talk much more about the methodology. If we think about the point of view of the consumer, issues about affordability are not just running through from infrastructure spend. There are a whole series of other things that affect your living standards and your cost of living, from council tax to import prices and the fact that sterling has devalued by 30%.
So the Treasury has an affordability framework that goes wider than infrastructure and tries to capture all the big macro influences on the cost of living. We have paused to think about whether it makes sense to have an affordability framework that is only about

infrastructure, rather than trying to capture these wider effects, but I do not think that we have completely ruled out coming back to it.

Q163 Chair: I hear that, and it is important to do the macro work, but equally I think the decisions around infrastructure ought to be also influenced by some view on affordability. Energy prices and electricity bills are hugely important to people, so you have to think about that before you decide the level of subsidy or how you are going to keep the supply going. You have to think about it.

Geoffrey Spence: I think we do, and we do it very carefully on a sector by sector basis. We have spent a lot of time looking at what the impact of energy bills will be. That was a crucial part of the levy control framework that was negotiated between the Treasury and the Department in terms of setting what the cap would be on consumer bills up to 2020. I think the disagreement that we have had here is that we just do not quite see what the merit is of actually aggregating it all together across all these different types of infrastructure, rather than over the whole picture of cost. So we do look at this on a sector by sector basis quite carefully. We spend a lot of time looking at affordability, although a lot of the real information that we derive from that does come from the work that the Departments do, which is quite extensive.

So the disagreement is that we are not convinced that putting all infrastructure centres together is particularly easy or helpful, rather than looking at the total cost, but we do think it is really important to look at the sectors and affordability for energy, rail and so on.

Q164 Chair: I have two more questions. One is about the Treasury's role and the argument about whether you should go for rail or road—in other words, prioritisation. Do you get involved in that?

Sharon White: We do. A very live example was in the autumn statement: the additional capital investment of £5.5 billion. We certainly looked very closely with the Department—the Department obviously has all the expertise—at what would have the biggest economic impact, particularly with the line where you have spades in the ground early, so you get the construction and employment effect. One of the things that is striking is that on the roads side, particularly when you look at roads maintenance, it has one of the fastest, largest paybacks. That is one of the reasons why the Prime Minister has been keen for the Department to have a wider look to see whether we can find a way of getting sustainably higher levels of road investment.

Q165 Chair: My other question is about geography. Do you look at whether you should have the infrastructure investment in London and the south-east or whether—Nick Smith raised it at an earlier stage—we should have more investment in the Severn barrage? Are we trying to geographically spread economic growth on a regional basis? How is that deliberated and decided in the Treasury?

Geoffrey Spence: Infrastructure spend is a devolved responsibility, so there is an area of activity in this space which is actually the responsibility of the different devolved Administrations. Obviously, if you are doing a business appraisal on an investment, you are also taking account of the benefits that it could give in terms of connecting geographies. That is one of the major things that could be said in terms of the business appraisal that is done for HS2.

Q166 Chair: My concern is that with 300 priorities corralled under 40 projects or whatever things you are looking at, you are not really taking these tough decisions around region or between. I do not know whether you feel that you are. You may well be going for readiness and practicality of doing it, and that may be your overarching priority—I do not know, just get a feel for it.

Sharon White: Certainly with the most recent decisions we have been really concerned to see what we can get constructed in this Parliament. We do look at geography and some of you will have seen the pretty maps published at the time of the autumn statement. We are also concerned about regional geographical connectivity and particularly how the regional funds that we have—the regional growth funds and so on, where we have got lots of local infrastructure pots—can be better used. Geography is a factor, but to be frank, the biggest driver for the autumn statement package was economic impact and speed.

Q167 Chair: My final question goes on all these things. You have talked about the guarantees; we have talked about the subsidies. There is a line to be drawn between legitimate taxpayer support for the public good and actually then using taxpayers' or customers' money for private profit and without necessarily a public good. I understand it is a difficult line to draw, but all too often in this Committee when we look at the electricity transmission system—which we have raised with you now three times because we were so shocked by it—or when we look at PFI, we get it wrong. We stray across that line to, I think, excess profits at the private sector without really protecting the public good, whether taxpayers or consumers. How do you set about treading that line?

Sharon White: It is obviously something that we are really concerned to get more right in the future, partly because we have reflected on the work that the NAO has done and the scrutiny that we have had in this Committee. You will know that on PFI, now PF2, one of the things we are going to be mandating is much more transparency in terms of profit-making, both forecast and actual equity, which will help to get more of that information into the public domain. On the guarantees, we are putting in place a very structured framework so that we will have the same scrutiny of a private project as we would expect on a public project because public funds are clearly at risk.

Geoffrey Spence: We have now got a stated objective from the Treasury to actually attract and mobilise long-term sources of investment, both for debt and equity in our projects. That is a shift. It reflects the fact that we have lost our banks in terms of their ability to lend long term, and we actually have some problems with some of the other methodologies we had for this involving non-line agencies before. When we do an MOU with Joanne Segars with her pension fund platform, whenever we have dialogue with the long-term institutions that want to buy debt, what we are increasingly saying is that what we want are people who are not going to exit at completion of a project, but are actually going to be investors for the 30 or 40 years that that project needs.

Part of the reason why we are doing a guarantee scheme is to bridge the lack of long-term finance that we have now, to bring these new investors in. If we are successful, a lot of the problems that you have seen in the past—particularly where windfall gains have been crystallised for equity investors or others—will go away because people will not want to leave; they are long-term institutions who want that long-term investment and they do not want to sell at completion. I think that was what Joanne was saying, and where she and her funds are coming from, which is different from where a fund like Macquarie comes from. This is the shift from one world to another that we want to see, and which we are trying to facilitate but obviously cannot direct.

Q168 Meg Hillier: I am interested to pick up on the Chair's line about the regional approach to funding. When we looked previously at regional investment projects and programmes by different Governments over many years, despite billions of pounds going in, if you look at the economic outturn of each region, they are all in same pecking order they were in 20 years ago, from memory. You talk about economic development, but are you looking at the north-east compared with London, and thinking that the north-east is doing worse than London, so we want to put more money in there? It doesn't feel like it from where we are sitting.

Geoffrey Spence: I will make one point, but I think there is a macro point there, which Sharon would be best to answer. I would look at the announcement to do the Northern Hub railway. Within both the Treasury and the Department for Transport there was the view that one of our problems in the UK is that we have poor linkages east to west. That was definitely in everyone's mind, that that could stimulate growth in terms of making a decision under the HLOS framework, and was something we should spend money on. But there are obviously bigger, macro issues that are probably behind your question.

Sharon White: We certainly do focus on and worry about the regional disparities, partly with an infrastructure lens, but to be frank, we probably think more in terms of labour market interventions, the development of local enterprise partnerships and regional growth funds; so a much faster disbursing of funds than we see on the infrastructure side. It is a matter of how and where they are disbursed, with particular worries about local capacity. As you know, with the regional growth fund it is not for want of funding. Local areas are not able to bring together the partners and businesses to get the funds spent. The levers we are looking at more substantively are on the employment side, probably in terms of housing construction. We haven't talked much about that. Certainly, when we are debating social infrastructure and housing, where you have a 12-month time frame rather than a three or five-year time frame, we are looking outside London and the south-east.

Q169 Meg Hillier: In terms of economic infrastructure, look at Morpeth. I haven't visited for a while, but that former mining town became much better off—forgive me if it is not like that now—because the DWP put its headquarters there. There is a lot of politics around house prices and they may be a bit of a proxy. However, if you look at my borough, the East London line went in very quickly, a bit of Transport for London infrastructure, and that has made a huge difference to where people can commute from, north and south of the river, into central London. So infrastructure definitely makes a difference, because people do expect to commute now. It is interesting, Sharon, that you are talking about jobs and skills but people will travel, maybe out of the area, to jobs and skills, but still within the region.

Sharon White: The point I was trying to make was that in the absence of growth our focus has been very much on what we can do quickly to effect reduction in the regional disparity. That is why I said the mechanisms we have mostly focused on have been around fast—

Q170 Meg Hillier: I take it that is now because of the current economic situation. In the past and in the future we still need the long-term view.

Sharon White: Steve may come in on the transport side. On economic infrastructure, when we think about where to put our transport networks—the Committee probably has various views on HS2—a big factor in the Government's decision to go ahead with HS2 was very much about the connectivity of our northern cities.

Chair: There is an argument over that.

Meg Hillier: Salford is doing very well because the BBC moved there.

Q171 Chair: We're going to go to Salford and see whether that has worked.

Sharon White: If you look at the placement of stations, the two Manchester ones have been placed very much with that in mind, not in the city centre—a link to the airport and areas that are more deprived.

Q172 Meg Hillier: The Crossrail 2 proposal was unveiled yesterday. Crossrail 1 was funded partially by a public grant. Crossrail 2 would be fantastic for my constituents: the Hackney-Chelsea line would come to fruition at last, we hope.

Sharon White: I am not sure which direction.

Q173 Meg Hillier: The Department will look at it next year, Steve. Any hints about what the Department will think about Crossrail 2? Transport for London, under both Mayors, had a very good track record of delivery of things that work, on time and under budget. It is a genuinely good investment, as well as being a constituency import.

Steve Gooding: We have obviously got to look at it; we have all read the Mayor's very enthusiastic backing of it. I will share with the Committee that I have been here since the Government announced they were looking at it in 1987, when it was called the Chelsea-Hackney line.

Q174 Meg Hillier: We still call it that, don't we?
Steve Gooding: We will look at that very seriously, because when we are looking at connectivity, as Sharon said, the connectivity through London that spreads out and broadens the labour market is really important. If we are looking at the regional spread of investment, we have to keep in our minds that London is something of a generator for the country.
The thing about transport infrastructure is precisely that it is unlike deciding where to put an infrastructure facility. You are putting it somewhere either to facilitate or unlock demand for travel and access to jobs that is otherwise there. It is sometimes less good for causing that to happen. So if you take the East London line as an example, with demand building up, Transport for London was clearly seeking to unlock that, and the service was very popular from a very early stage. So that is another lens through which we try to look at the investment pressures: whether there is a latent pressure, or whether—let's take the fact that we are looking at the A1 north of Newcastle—that is something we are thinking more strategically about, with a longer-term perspective, which could help, albeit the pressure in terms of traffic demand isn't quite there now.
Meg Hillier: From a parochial, Hackney point of view that sounds good news.

Q175 Austin Mitchell: Why can't you tell us the effect of all this infrastructure spending on the poor old consumer? This is a question for Mr Virley and Mr Gooding. Utility costs, fares and average household income have increased from 8% to 10% over the last seven years. We know that household incomes are being squeezed. So it's another way for the Government of raising money, apart from tax. Can you tell us what the effects of these projects will be on consumers? Will that increase in utility costs and fares go on for the next seven years?
Simon Virley: In terms of energy, we think that the main driver behind energy bills going up is wholesale prices—world energy prices. None the less, there is a contribution from Government policy. The total effect of Government policy in terms of the average fuel bill is about 9% at the moment. If you convert, say, the subsidy for renewables, that is about £20 per household, which is paying for about 10–11% of Britain's electricity needs. That figure will rise and the support for low carbon will increase over time—possibly in the order of £100 on the average household bill by 2020, under the levy control framework which we have agreed. But you have to look at the impact on energy bills in the round, with all the other things we are doing to take money off bills: support for reductions, energy efficiency measures, the green deal and so on. The latest assessments we have done, which we have published on our website, suggest that we are taking more off bills than we are adding to them. So we think that bills will about 7% lower in 2020 than they would otherwise be.

Q176 Chair: May I ask a theoretical question? There is always a balance between putting it on the consumer or doing it through progressive taxation. Are you driven by deficit reduction to shove it on to the consumer, or do you think about that balance?
Sharon White: There is definitely a balance. It is partly fiscal, partly a question about economic efficiency. If it is on the user, will they use the service or the goods in a more economically rational way? Certainly, if you look at our discussion about rail fare rises in SR10, part of the drive behind RPI+3% was still to get the investment in but to load the cost where it was felt to be appropriate.

Q177 Chair: Where it was felt to be appropriate? It was better to do it through the fare payer rather than the tax payer—why? Were you just driven by cutting the deficit or were you driven by some other concept of fairness?
Sharon White: It is absolutely a balance. We look at the affordability from the public finance point of view. We look at economic efficiency. Will users use the service in a more rational way if they have to bear a bigger share of the cost? On transport there is still significant public subsidy because there are wider benefits to non-passengers—Ms Hillier's point around connectivity. You may be benefiting even if you are not a travelling passenger. All those judgments are weighed together.

Q178 Austin Mitchell: It is really nothing to do with balance or fairness, is it? Corporation tax has been reduced while heavier and heavier burdens are being shoved on the back of the poor old consumer. That is what is happening and that will go on, presumably.
Sharon White: The changes on corporation tax are part of trying to improve the environment for business. In the last year there have been a number of actions that the Government have taken because of concerns about the cost of living, whether that is the council tax freeze or the delay in the rise in fuel duty, which was due to go up by 8% in real terms this Parliament and will now fall by about 7% in real terms this Parliament. All these things are very difficult to balance. But the cost of living has been an increasing issue of concern as the Parliament has worn on.

Q179 Austin Mitchell: We never got Mr Gooding's answer.
Steve Gooding: What I would say, and particularly thinking of rail there, is that there are three things in play. One is, the more people who are travelling by rail, the more that cost is being spread. Secondly, the Government has been clear that it wants to get away from above-inflation fare increases. The third thing is seeing through all the things that Roy McNulty identified in his study of the railway to take cost out. So there is a sustained investment but a reduced ongoing cost of sustaining the railway. For those reasons I think we are all aiming not to be, as you put it, loading more and more cost on the household.

Q180 Austin Mitchell: A final question for Mr Spence. I wonder how far you maintain some kind of regional balance in this infrastructure work. It always seems to me that London gets everything and we in the north get the fag ends. The M62 is choked up every time I drive it. The east coast line is shockingly choked up at rush hour. The north does not seem to get any big infrastructure projects and yet it is the most depressed area. It is the area most in need of jobs and investment.

Geoffrey Spence: I can understand why it looks like that. Of course London and the south-east get a lot of investment because of the size of the economy in the south-east. But I would point out that the Government is committed to HSR2—

Austin Mitchell: That is not an investment; that is a white elephant—

Geoffrey Spence:—to the Northern Hub and other rail infrastructure, and to the Mersey gateway bridge. There is quite a list of investments in the north that are there to improve connectivity for good or ill in the minds of individuals. There is some balance to the investment that is made.

Austin Mitchell: It is all in favour of London.

Chair: I am sure we will keep on with this conversation. Thank you very much, all of you, for coming this afternoon.

Printed in the United Kingdom by The Stationery Office Limited
04/2013 027635 19585