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Pipers and Tunes: Putting the Road User in Charge

'Paying for Roads: What is the way forward?'

Phase One Report

October 2012

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October 2012

Independent Transport Commission
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Pipers and Tunes: Putting the Road User in Charge

‘Paying for Roads: What is the Way Forward?’

Executive Summary

Britain has changed immensely in recent decades, but the way in which roads are managed and used belongs to a simpler, more dirigiste, era. Road users aren’t treated as customers, and they’re certainly not calling the shots. Drivers face a heavy tax burden, but they don’t pay for the use they actually make of what is the last ‘free’ utility; and partly as a result roads have been low down in the queue for necessary investment.

Government is now seeking to atone for past neglect and is assessing how it can best lure large-scale private investment into England’s road network as part of its economic growth agenda. As the Prime Minister announced in his 19 March Infrastructure Speech, the key question we now face is how to find ways of financing the infrastructure we need within severe public spending constraints.

At the same time, the Government would like any change to strengthen rather than undermine its engagement with motorists. It is, as the PM suggested in his speech, a question of creating a power shift, by placing more power and choice into the hands of the people.

The ITC, as an independent think-tank addressing pan-transport challenges, believes both aims can be met. And we are convinced of the economic and social case for increasing investment in the quality of our roads. Even if overall traffic is no longer inexorably on the rise, each of the increasing number of individual users deserves a better service from the network.

We understand why it has been so difficult to make headway on roads reform. With new motorway building now behind us, roads have literally become part of the landscape, and the public increasingly tolerates congestion as a fact of life. The significance of motoring revenue for the Exchequer means that Government has so far resisted any form of hypothecation. But it cannot now ignore the steady decline in the transport tax take forecast by the OBR as increased fuel efficiency eats into receipts from Fuel Duty and Vehicle Excise Duty. This finally provides the imperative to grasp the nettle of roads reform.

Refreshing Road Governance

The Prime Minister noted that we should ask ourselves why other infrastructure is funded by private sector capital through independently regulated utilities, but roads are still on the public

books. The ITC strongly supports governance changes, already started by the Cook Review and others, which follow the model of successful reform in utilities such as water, and aim to manage roads more cost-effectively and more accountably These would vest responsibility for running and enhancing England's Strategic Road Network in a ring-fenced body, free from the pressure of annuality in Government financing, but endowed with some form of secure revenue stream. The private sector, and especially unquoted companies, may be in the best position to use that revenue stream to raise long-term finance from international investors on the scale needed - but we should also use restructuring to establish the most effective relationship between the road user and the service provider.

With a newly invigorated roads sector exploring the opportunities for innovation and chasing best practice, we could seek a mix of governance models for road operators; but mutual and other non-company models, whilst able to deliver stronger accountability, may be less efficient at raising finance. Such models would be better deployed at a higher level: we propose that a new Roads Trust be set up as the key intermediary between Government and operators, independent of both. As the key tool for securing public buy-in to the reform, its role would centre on:

- establishing an overall remit from Government, including the high-level output requirements from the network over the next investment period;
- agreeing with road operators the terms of their licences, and the performance and investment specification that is tied to each operator's share of the available funding as allocated by the Trust
- working with an independent economic regulator to ensure investment is efficiently delivered
- creating a framework for coordinating the road network, so that it is more capable of responding effectively to crisis events, and so that common standards are maintained across it
- developing a prominent public profile in pursuing the interests of road users, including through advocacy of improved safety and reductions in the wider cost of motoring

The legal status and governance of the Trust will be whatever best makes this happen, and secures the confidence of users and investors alike; crucially, its relationship with the road operators must not prevent their debt being classed as private sector. As for its scope, that should simply be the extent of road network in England that would best benefit from this change. There is a strong case for this going beyond the HA's Strategic Road Network if it is to embrace the bulk of the driving experience: through partnerships with local highway authorities, the Trust could take on oversight of the wider (green-signed) Primary Route Network – in return for taking a share of the local roads funding currently flowing to local authorities.

Better Value from Road Charging

For the past decade, reform of how we run the network has often been equated with the spectre of road pricing – arguing alongside that pricing to manage demand removes the need for major new investment. The Government has been very clear, however, that we must achieve a step-change in investment without any additional user charging (other than tolls on newly built stretches alone). The ITC believes we need, across the whole network, both investment and fair charging, and we urge Government to use this opportunity of the current Feasibility Study to plan, alongside a clear committed programme of investment, a more rational price on road use.

In theory, road charging, in the form once pursued by the last Government, could raise significant new revenue to counter the decline in tax receipts. However, the ITC believes that progress towards funding reform can only be made by focusing simply on a fair charge for road use itself. It is essential to overcome the public cynicism that has built up around the Government's attitude to motorists by giving assurances that they will not be taxed still further. Instead we should create the climate where drivers are willing to pay more for a better service, if they so choose. That doesn't mean giving a green light to new routes all over the countryside; it does mean channeling new investment more into smaller enhancements, easing bottlenecks, increasing safety and mitigating environmental impact - schemes which usually bring the greatest economic returns.

Drivers as Customers

But we are not going to achieve the crucially important engagement from users without making them in some way paying customers; they would be oblivious to a simple redirection of existing Government expenditure lines. Treasury is currently reviewing the structure of Vehicle Excise Duty bands; we are keen to seize the opportunity of VED reform to establish, in a subsidiary regime for England, and crudely at first, different levels of payment for different levels of access to the network. A new standard level of VED would allow full access, as at present, but with discounts then offered for those not using the busiest stretches which have had the most investment, such as the 'managed motorways'. The standard level could be nudged progressively upwards as new improved stretches open, thus generating an identifiable extra revenue stream to help fund schemes such as the A14 upgrade in Cambridgeshire - far more efficiently than by setting up a scheme-specific local toll collection mechanism. From the outset, and with low-cost enforcement through Automatic Number Plate Recognition (ANPR), we can see the new standard level generating in the order of £800m pa extra, which could be distributed by the Roads Trust to secure private sector investment in a long-term enhancement programme.

This would start to influence decisions on driving at peak periods. And it could lead on to a second stage of reform: once the new governance structure is bedded in, the rising VED element could be converted from a tax collected by Government into a charge for road use set directly by the Roads Trust. As it develops better understanding of what motivates its customers, the Trust could offer an increasingly sophisticated range of tariffs structured to meet drivers' different needs from the network. Following the precedent of increasing take-up of Pay-As-You-Go insurance, drivers might opt for a service package where their usage is monitored more accurately by GPS, rather than ANPR. This is not the imposition of road pricing, but rather creating the climate in which drivers choose the fairest way to pay for the service they get from the roads.

ITC has always seen public acceptability as the key challenge for any reform proposition. Our initial soundings indicate that motorists are receptive to sensible reform in which they can have influence and from which they can benefit; our next phase of work will focus on exactly how this programme could best secure and sustain public buy-in.

We believe that the incremental nature of this proposal, coupled with an assurance that the total tax on motoring will not rise, provides the core of an attractive route map for politicians. As happened with the water industry, reform can bring forward necessary investment in vital infrastructure. And the central role of the Roads Trust would underline the message that this change programme is in the users' interest: citizens using roads would be treated as responsible paying customers entitled to a fair deal, just as they are when using other essential services.

Introduction

The Independent Transport Commission, under a Steering Group led by Steve Norris, began work earlier this year on a route map for establishing a sustainable basis for paying for road use. It is producing this interim report now to feed in to the Government's current Feasibility Study into new ownership and financing models for the national road network.

Having established the continuing need for investment in roads, this report summarises the many challenges inherent in the current approach to governance and funding, and the key objectives of options for reform. It then homes in on a preferred new model which we believe could make it possible to meet those objectives within the next Parliament, and as it then evolves make a major contribution to economic growth and so indirectly to Exchequer receipts. Finally, the report focuses on key considerations of public acceptability, with pointers to the more substantive work the ITC plans for the second phase of this project.

1. The Case for Investment in Roads

An efficiently functioning road network is and will remain a precondition for economic activity and for maintaining our standard of living. Roads are not just a concern for business and motorists, but are an essential component of all mobility, personal and freight. Travel by bus, cycling and walking rely, like driving, on the quality of roads, and almost all rail journeys depend on road connections as well. Investment in roads is not therefore at the expense of a commitment to more sustainable travel, but an essential element of it.

The UK has the most intensively used road network in Europe[i], presenting particular challenges for resilience and for those living alongside it. The pressures are worsening: in the 20 years to 2011, traffic grew by 19%, on a total network only 10% longer; new roads were almost exclusively for local access only, as the main road network actually shrank by 1% over that period[ii]. Average daily traffic flow on British motorways is now well over twice that on French equivalents, and 50% higher than that in Germany[iii].

Road traffic growth has levelled off in the last few years and this may not just be a temporary consequence of economic recession; the ITC is currently examining the significance of this current stagnation. The long-term propensity of individuals and businesses to use roads may now be lower because of lifestyle and planning changes, and because of improvements in alternatives - but these may not be sustainable or affordable in the long term; furthermore, it is still prudent to plan for a return to road traffic growth simply because of increased population and the size of the UK economy in the longer term.

Economic growth and prosperity do not just depend on physical infrastructure alone, but a strong argument can be made that in recent decades the UK has invested far too little in it; the Prime Minister himself highlighted this in his speech in March[iv] which launched the current exploration of options for roads, and which painted the contrasting picture of the water industry, where private ownership and independent regulation have succeeded in bringing forward the massive investment that was needed. Focusing on the needs of transport alone, Sir Rod Eddington showed in 2006 that there would be substantial economic gains from focused investment on improving existing transport networks. Since then, whilst successive Governments have committed to increasing investment in rail, including the headline £9bn figure in the new High-Level Output Statement from 2014, the shortfall in roads investment has simply been exacerbated: the 2010 Spending Review set a 35% cut in capital funding for national roads, only partly restored through subsequent acceleration of 'shovel-ready' schemes.

As the RAC Foundation has found, there is a long queue of highly worthwhile road schemes awaiting funding with benefit-cost ratios averaging 2.8 to 1[v]. The inability of current arrangements to divert available capital – either public or private – into these projects means the country has to tolerate continued costs in terms of lost travel time, adverse environmental impacts, and injuries and vehicle damage. 13% of road accidents are directly attributable to poor road condition or design[vi], and much of the remainder could be mitigated through greater attention to road layout to support better driving.

The priority for investment must be in maintaining and enhancing the quality of the existing network, rather than in building new routes. But current arrangements make it impossible to identify what the optimal level of investment in the asset should be. Whilst clear accounting is now in place for the Highways Agency, with its £108bn fixed asset base, there is no systematic commitment to current cost accounting across the network, picking up local highway authorities as well. Without transparency we can only guess the size of the investment shortfall.

Completing the approach of treating the road network like any other business asset would of course entail that we then charge a fair price for its use. Effective pricing of road use would manage demand where capacity is constrained; but it would also go on to send clear signals on where extra capacity is needed, in cases where demand for road space as indicated by willingness to pay is well above the supply. Even if traffic were not to grow further ITC is clear that pricing would not remove the need to improve the network, perhaps through putting roads into tunnels in conurbations where the economic case is extremely strong[vii]; it would be sub-optimal not to respond to these signals, simply using pricing to reduce demand. That would arguably amount to abuse of a dominant position in competition terms on the part of highway authorities.

The Government has made it clear that its current study is not about a move to charging for the use of existing capacity, but changes to governance and possible funding streams do have the potential to set Government on a path towards some form of road pricing. Whilst understanding the sensitivities facing politicians, the ITC believes it is crucial that Government seize the full opportunity of the reforms needed now and ensures that it doesn't close the door on a possible later commitment to road pricing - given the very substantial benefits that the ITC, and many others, have demonstrated could flow from charging the right price for road use.

2. The challenges inherent in current governance and funding arrangements

Since the 1980s the way in which most public services are delivered has been transformed, but despite a succession of options being tabled, the roads sector has changed little. Five key features of the current landscape explain why successive Governments have not felt able to overhaul the governance and funding of roads to realise the full potential of the sector:

(a) *The importance of taxes on motoring as part of general revenue raising*, which makes it difficult to separate out a policy response which meets the specific transport need:

Formal hypothecation of what is now Vehicle Excise Duty ceased nearly 80 years ago, but it has remained at modest levels (total receipts at less than £6bn pa). By contrast, conveniently collected through the oil majors, Fuel Duty has been easier to exploit, with receipts having grown to £32bn pa. Taken together, motoring brings in 7% of total exchequer receipts. After expenditure on the infrastructure to support motoring, that produces a net contribution of some £30bn to wider Government spending; 'schools and hospitals' have arguably come to depend on it.

Not surprisingly taxation at this level means spend on private road transport accounts for a substantial part of most households' budgets, but the two Duties bear little relation to the actual use made of roads, and so cannot currently act as a user charge for the service provided. The one policy goal in which they have been effective has been in increasing fuel efficiency, with VED increasingly used (alongside the company car tax regime) to incentivise change in the vehicle fleet.

The motor industry and drivers themselves have responded very well to those signals in motoring taxation on fuel consumption, to the extent that the OBR forecast that by 2030 transport taxes will fall by around a third, by £13bn pa. This looming shortfall should provide the single biggest spur to Government action to reform how we pay for road use.
The ITC recognises the challenges in seeking to fill that gap from other sources, but tax policy should be based on what is economically efficient rather than simply expedient. And grassroots pressure may make it difficult to keep relying on road use as such a disproportionate net contributor to the Exchequer.

(b) *The dual role of the road network as both an essential business tool and a key part of the public space.* Roads are unlike other business services in that the public have a direct personal interest in what is provided, and the extent to which we all rely on roads for so many aspects of everyday life makes commercialisation uniquely challenging. It is not a just a matter of ring-fencing strategic routes: roads only function as a complete network, and significant lengths of even principal roads are lined with homes and support essential services, including utilities.

(c) *The arbitrary split between central and local government responsibilities, and the absence of any user involvement in delivering the service.* The Government's direct role for roads in England has been reduced in recent years to a core set of strategic routes, but anomalies remain and numerous local highway authorities are also now responsible for some major highways of more than local importance. There is no branding to enable users to understand who is providing the service, and, particularly in the case of local authorities, owning 98% of the network, little sense of a customer relationship. In contrast to when they use public transport, people when on a car journey have no consumer representation and no undertakings as to the level of service to be provided.

(d) *The absence of any committed programme of public investment tied to agreed deliverables.* Central to the regimes now in place for other elements of the national infrastructure such as rail and the utilities is a clear mechanism for determining and delivering on the investment needed to maintain and improve the asset over the multi-year timescales demanded by infrastructure planning. The absence of any such set of responsibilities for roads results in inefficiencies, for both the contracting industry and for users; and it means that the progress of highly beneficial investments is at the mercy of short-term pressures in other areas of the Government budget. Alongside the lack of meaningful service level indicators for the public, the Highways Agency and other highway authorities are not tied to meeting service specifications from their networks, and there are no penalties for non-compliance.

(e) *The absence of incentives to tackle the major safety disbenefits of roads.* Given the scale of casualties on our roads, at a level which would not be tolerated in any other part of the public realm, it is worth singling out the disconnect between the provision of road services and the cost of dealing with the poor safety record. Highway authorities have no financial interest in safety, with costs falling instead on the NHS and, through insurers, on drivers collectively; this increases the financial pressure on the nearly half of all lower income households who now judge they need to run a car[viii].

Taken together, these flaws in the way roads are managed and funded generates a great deal of public cynicism, which itself becomes an obstacle to intelligent reform. Motorists feel that in return for a growing bite out of their income they have a deteriorating user experience, and they mistrust Government's motives for bringing in solutions. The heart of the problem has been the sheer popularity of car travel, so our own driving habits have to be part of the solution. But Government must make a start by putting in place a more rigorous, transparent structure that enables sensible decisions on when and where to drive to be made.

3. The way forward on governance

With the roads sector lagging behind other public services in reform, it's not surprising that there is a wide range of precedents to draw on, with varying records of effectiveness. There has been careful assessment of how these approaches might provide a model for reforming roads, with, amongst many examples[1], the RAC Foundation recommending that major roads be vested in an independently regulated public corporation or privatised utility[ix]. The Cook Review last year[x] proposed a strengthened role for a more autonomous Highways Agency whilst remaining wholly within the public sector, and in its response Government is now taking welcome first steps towards this reform – whilst delaying any decision on the best funding regime.

It's clear that no one structure is ideal, and that there must necessarily be a process of evolution from the existing arrangements, preferably testing out some new features before committing to wholesale change. The Feasibility Study itself has understandably modest aspirations, but with the Prime Minister flagging up the water industry as a possible model, it's important nonetheless that we set a longer-term goal that works for roads, to determine the direction of travel now.

Given the challenges identified above, seven key requirements should be set for that endpoint to meet. Two are clear from analyses already published:

(i) Providing long-term stability with scope for innovation, through contractual arrangements of sufficient duration to draw in investment but with periodic contestability to stimulate fresh approaches; and

(ii) Establishing entities, off the public accounts, which can be funded in the first instance through Government receipts as the basis for raising finance for investment, with AAA-status to minimise financing cost.

And alongside these ITC seeks a focus on five more requirements, making the most of this opportunity to design a new regime:

(iii) Tying the rewards for the new managers firmly to performance of the roads, with indicators to be devised incentivising improvements in safety and environmental impact, as well as in traffic flow;

(iv) Establishing a closer relationship between the user and the service provider, to reinforce accountability and enhance the user experience;

(v) Providing the basis for an attractive overall proposition that can be sold to a properly informed public, through clear structures and embedding trust from the outset;

[1] In one further approach, the Social Market Foundation has tabled an interesting idea of 'voucher mutualisation' of the entire network, but as citizens sell the stakes issued to them it is not clear that the end result would be much different from outright privatisation.

(vi) Being potentially applicable to more than just the Strategic Road Network or some subset of the HA's roads, to maximise benefits and ensure alignment with the reality of usage patterns;

and finally, in line with the desire to trial options as part of the roll-out process,

(vii) Enabling a variety of business models to be run in parallel within the new structure, to enable benchmarking and some element of direct competition between service providers.

An ITC Discussion Evening in July, led by senior players in transport delivery, considered the merits of different models of ownership in UK transport, looking beyond the Government agency and Network Rail models to the contrast between public and private limited companies. Private companies were felt to have the advantage of being able to attract long-term investment without being prone to the short-termism affecting some public companies. As long as regulatory measures can be taken to mitigate the natural monopoly aspects of fixed infrastructure, the meeting felt that either form of private ownership was more effective than the alternatives in attracting international capital (equity as well as debt) and management talent in a low-risk environment. But the source of funding will be critical in determining the best ownership model.

ITC wants to see funding and governance structures which open up operation of roads to private sector entities, as well as enabling other approaches to be tested in parallel. We note that simple privatisation of infrastructure proved highly problematic in rail and would be even more challenging for roads given the still stronger sense of public interest.

ITC is therefore attracted to a two-tier structure, with a range of road operating entities - private and public companies, but also perhaps mutuals or companies limited by guarantee - granted licences to operate sections of the network by a new non-Governmental body. These operating companies should be regionally based, to aid benchmarking and identification with regional priorities. There should ideally be a spread of corporate governance models – public and private companies, mutuals, perhaps offshoots of key stakeholders such as the motor industry – as long as they can all raise the necessary financing.

The higher tier would allocate Government funding to the operating entities to carry out investment programmes to which they have committed, to include top priority projects such as the A14 and A303 as well as small-scale enhancements across their network; the larger the programme, the longer the concession (we suggest a range of between 7 and 20 years). Crucially, this new body should be demonstrably run in the interests of road users: essentially a Roads Trust, modelled on precedents in the USA and Australia.

Learning from US and Australian experience

The Highway Trust Fund in the USA is fed transparently by hypothecated taxes on fuel, tyres, vehicle sales and penalties for traffic violations; it funds the Federal-Aid Highway Program on a pay-as-you-go basis, but has been diverted to meet general deficit reduction targets.

Learning from this experience, we need:

- commitment to long-term funding in national interest to be sustainable and irreversible from the outset;
- the investment programme to be directly and clearly for the benefit of those who pay – eg targeted park and ride services acceptable, but not public transport investment in general
- not just transparency of the levy; to avoid just being an administrative device, there has to be widespread recognition of the Trust's objectives and expertise – and effective engagement with road users;
- to plan for a switch once established to funding through a user charge rather than a tax to avoid the risks around maintaining hypothecation

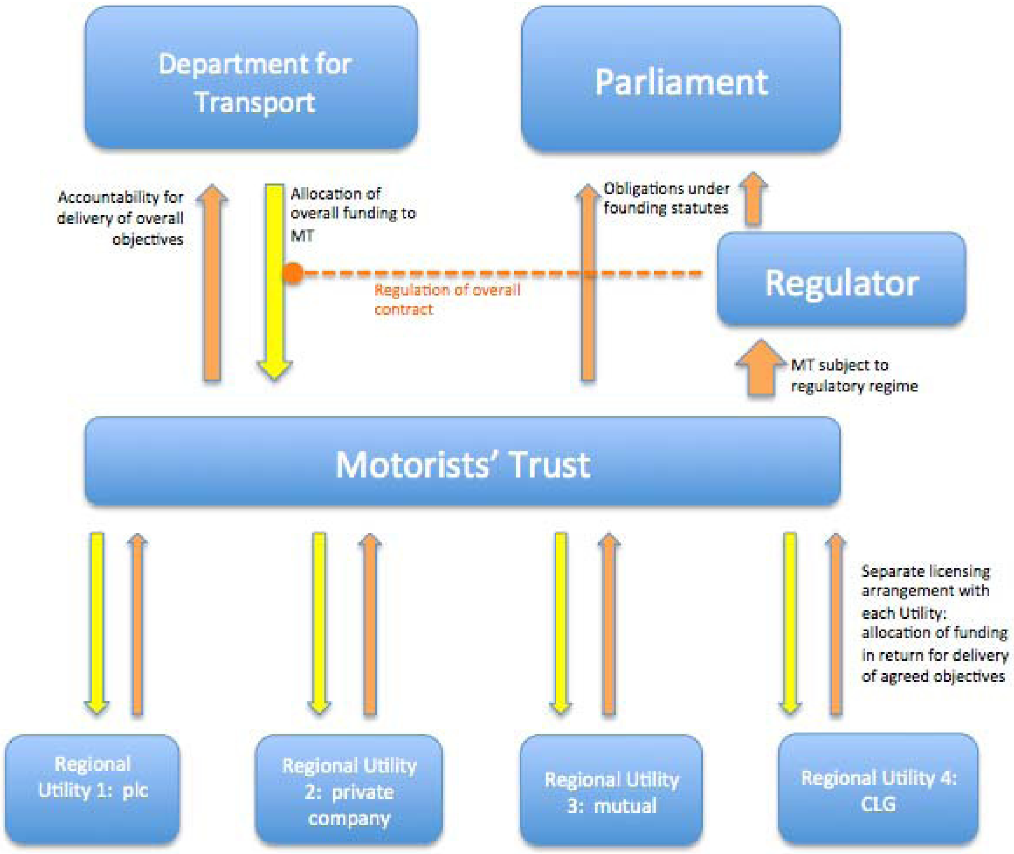
The Transport Accident Commission in Victoria, Australia has to meet the costs of bodily injury claims on a 'no fault' basis. We should aim to embed strong safety incentives in contracts granted to road operators here.

The Roads Trust would need to be established by Parliament, but beyond that we do not specify at this stage how it should be constituted; that should be determined by its functions. Essentially, these would comprise:

- establishing an overall remit from Government for each successive investment period and the total available funding;
- licensing road operators to operate subsets of the network, contracting with each to deliver specified performance and investment in return for their allocation of the total funding from Government;
- monitoring performance by operators, and ensure that innovation did not conflict with consistency in national standards in eg signing and the increasingly important interface with ITS-equipped vehicles;
- acting as a safety inspectorate for roads, independent of both Government and the operators, tasked with disseminating the learning from investigations into incidents; and
- taking on a wider advocacy role for keeping motoring affordable, overseeing the operation of the motor insurance market.

The Trust would build a strong personality independent of the government of the day, sufficient to secure user buy-in to a programme of reform in the national interest. There could be a mix of trustees, representing the interests of motorists and other road users, alongside a minority from central and local government.

Outline governance structure:



A Trust has limitations, not least its difficulty in accessing capital. Here that will be a task for the operating entities, but they will need an independent regulator to perform efficiently. The Trust could not itself take on the role, scrutinising its own decisions: the allocation of the total funding pot will inevitably be controversial, given continuing tight budgetary constraints and the impacts on different regions. Investors in the operating entities would need independent assurance that the funding was adequate for them to deliver the performance they are tasked with, and objective criteria would be needed around the extent to which the operating entity is committing to invest in improvements, and then the usage made of the improved stretches.

Consideration should be given to whether this regulation function could in fact be carried out by an enhanced Office of Rail Regulation, given the strong parallels between rail and road infrastructure management and the ability to learn from its wealth of experience. The function would employ the same Regulatory Asset Base approach as for the rail network, and a parallel process to rail's High Level Output Statement. Whatever the structural decision, investors and users alike would need to have confidence in the regulator and the approach it takes.

Assessment against the seven key requirements: This approach not only draws on existing recommendations to establish the ring-fencing from Government that is the precondition for meeting requirements (i), (ii) and (iii) above, but also allows for diversity of business model (requirement vii) and provides a strong framework for a persuasive proposition (v). Success with the user relationship (iv) depends on the source of funding put in place, covered in the next section.

Very careful attention will need to be given to how the combined structure of Roads Trust and road operators will be classified by the ONS. It is essential from the start that all debt financing raised by the operators falls outside the public accounts, and so decisions on governance of the Trust, and where legal ownership of the roads assets lie, will be critical.

That just leaves the geographical extent of the reform, where there is also promising ground for innovation. There is in principle no reason why equivalent ring-fencing cannot be instituted for a local authority's road network: some of the bigger county Local Highway Authorities (LHAs) have extensive networks with identified investment needs on a scale that could justify licensing in this way. This would be a major step forward in building a stronger relationship between users and the service they use on a daily basis. But it would be very difficult to tailor the regulatory regime to address the sensitivities of local roads, and to establish a source of funds to feed new operators of local networks. We recommend a unified approach instead, extending the responsibility of the Roads Trust beyond just the HA's Strategic Road Network to cover the whole of the clearly branded, 'green-signed', Primary Route Network. That would entail establishing partnership arrangements with the LHAs who share ownership of the PRN with central Government.

It is a relatively straightforward matter to map out an overhaul of governance structures in this way - but the practicalities of funding will dictate the pace at which change can happen.

4. The way forward on funding

Ring-fencing on its own would bring substantial advantages, even if the new structure were simply funded by diverting into it the DfT's existing budget provision for roads. This in itself would be sufficient to provide the revenue stream needed to attract infrastructure investment funds; whilst we shouldn't expect to be able to lock in for a long-term deal to the record low interest rates currently prevailing, there is still a strong case for getting the ball rolling now to exploit the UK's strong credit rating. But Government appears reluctant at present, in its response to the Cook recommendations, to go down the direct funding route if that entails it making a commitment over several years.

That resistance could be bypassed if the funds flow were to be related, for the first time since 1936, to the obligations of users of the roads - some element of Pay As You Go. What is needed is a well-constructed game plan that can meet all our long-term objectives without raising the spectre of road pricing. The case for road pricing is well understood, but it would take time to implement a political strategy needed to overcome key strands of public resistance around trust, privacy concerns and cost.

Instead, the ITC proposes that a <u>two-stage process</u> gets under way in this Parliament, choosing as the platform Vehicle Excise Duty, a tool which is widely accepted, difficult to evade and relatively modest in its impact on household budgets. Yet it is also ripe for reform. The increased complexity of VED in recent years has been successful in increasing the proportion of more fuel-efficient vehicles in the fleet. The current Treasury review of VED needs to reposition it as an effective tax for the next decade, and this must entail a return to more meaningful duty rates for even the lowest-emission vehicles. Fuel Duty is perfectly capable of providing strong incentives on CO2 emissions (and indeed is the equivalent of a price on carbon some four times higher than implied by DECC for other sectors[xi]), thus freeing up VED to perform a key usage-related role.

(i) Stage 1: VED as a usage-related tax

The overhaul of VED should replace emissions-related banding with options tied to different levels of access to the network. The challenge will be in achieving the optimal combination of simplicity for the user, beneficial impact on driving patterns, and generation of an identifiable extra revenue stream. The simplest approach might be to offer a lower rate that excludes motorway use. But we must avoid large-scale diversion on to less safe all-purpose roads, and this risk would be particularly high in regions with only sparse motorway stretches (eg it might be rational for drivers in the South West to opt for the lower tier of VED and divert to the Somerset A38 or A303 instead of the M5 when necessary). It would better meet our transport policy objectives, through incentivising more efficient use of the available capacity, if the lower rate only denied access to congested stretches of motorway: Brian Wadsworth of the Road Ahead Group has put forward a persuasive proposition[xii] based around clearly defined 'peak zones': only payment of the higher rate permits usage of motorways when operating as Managed Motorway (which provide the ANPR camera infrastructure needed to monitor usage).

It would be crucially important for establishing public acceptability to present this full network access, including Managed Motorways, as the standard level of VED, with more restricted access available in return for a rebate off that standard level. Where those signed up to the lower rate do nonetheless on occasions opt to use the Managed Motorway stretches, the extra payment due would need to be collected through reducing the discount on offer in the following year[2].

It would be logical to extend the scope of this VED proposition progressively to improvements made to other parts of the Strategic Road Network, or even the Primary Route Network; indeed, the decision on how much of the network to vest in the Roads Trust would depend in part on what can best minimise the risk of diversion away from 'peak zone' roads. In July, Government announced that it was working up a solution to the problem of the A14 in Cambridgeshire that involved tolling a new core route for through traffic, although no view had yet been formed on how users should pay. There are strong reasons for seeking to avoid scheme-specific charging such as this, requiring payment for that journey alone: the added overhead of dealing with occasional users; the challenge of ensuring compliance; and the much higher risk of diversion on to local service roads also being provided if the user has to choose at the point of use whether to pay up. It would be far preferable to spread all the costs by including this scheme, and other priority improvements such as the relief of pinchpoints on the A303, as additional potential 'peak zones'. ANPR equipment would need to be designed in to these SRN improvements, to calculate the extent to which the driver's discount can be maintained.

Defining the 'full network access' VED rate as the new standard does not mean that it has to continue at the present level. It is important to establish some additional revenue flow from those drivers who will value the best level of service from the network, and the more extensive the extra access available to those paying the higher rate of VED, the greater the differential between the two rates could be. Government should use the opportunity of the VED review to radically overhaul the structure of the tax, establishing a monthly payment option and a new standard rate (for cars and vans) significantly above the average of around £167[xiii] pa currently being paid (still well below some of the highest rates in the emissions-based tariff[xiv]); the increase would be justified by the demonstrably improved service that will be provided.

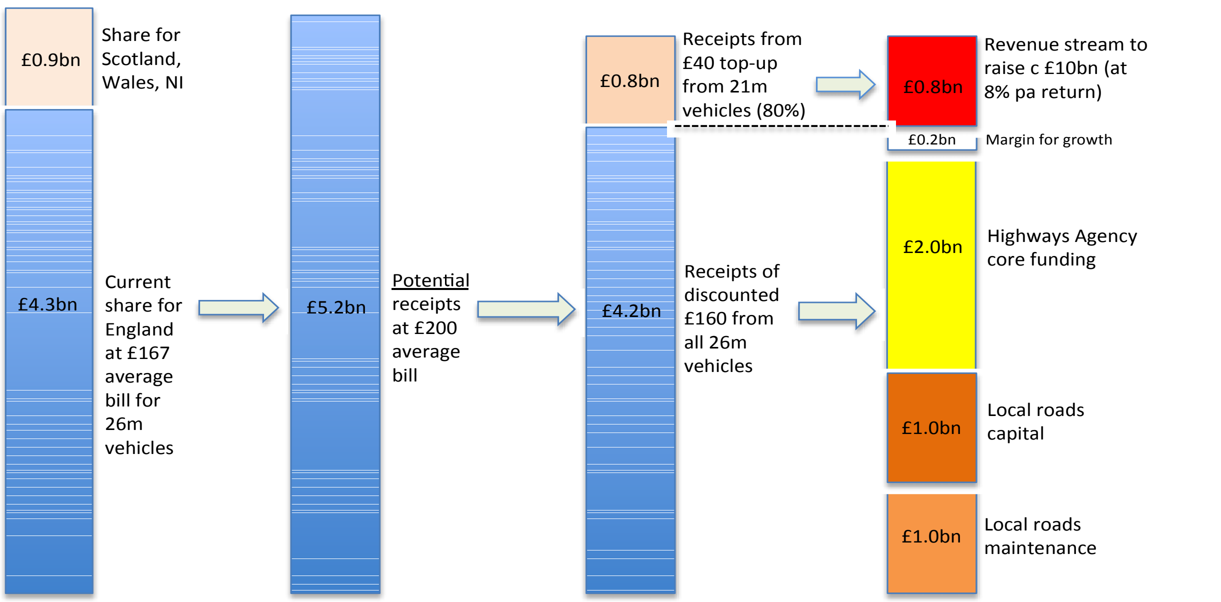
[2] Wadsworth proposes this is implemented by allocating all drivers 'discount points' which they can either use up through occasional use of 'peak zones' or cash in to pay a lower rate in the following year.

The proceeds from the premium payments would then be ring-fenced to constitute the revenue stream through the Roads Trust[3] that secures the new investment from international infrastructure funds. The diagram and supporting text box aims to give some indication of the scale of revenue that could be generated, based on just two VED options (£200 and £160) and a mooted English 'share' of UK-wide VED receipts (allowing Scotland, Wales and Northern Ireland to go their own way with their share of the pot – see box). It also assumes that all VED receipts are dedicated to roads-related expenditure, with no net contribution to the general Exchequer (Fuel Duty would continue to perform that role in this first Stage). This approach offers the prospect of a virtuous circle: the higher the standard VED rate over time as motorists pay more to access a wider spread of improved roads, the bigger the pot available to secure investment in additional enhancement.

Simplified flow of funds

all figures per annum

Total UK VED receipts (cars and vans) £5.2bn



[3] This would be in addition to the core HA funding that would pass to the Roads Trust, topped up by an appropriate share of local roads capital and maintenance allocation if it is also taking on responsibility for the PRN.

Establishing a usage-related roads fund from VED receipts[xv]:

- 31m cars and vans on UK roads, of which 84% (26m) registered in England
- Suggest new standard rate of VED to be set at £200 pa, an increase of £33 (all raised from drivers of lower emission vehicles least impacted by higher fuel prices)
- Total revenue potentially raised for England: £5.2bn, up from £4.3bn.
- Total roads expenditure in England: c £4bn at present, comprising £2bn HA roads, £1bn local roads capital, and £1bn (net of parking revenues) local roads maintenance. (Total roads spend in Scotland, Wales and Northern Ireland requires a further £2bn, with VED receipts of c£900m; devolved administrations would pursue their own solution, albeit with more constrained funding than at present. Maintaining change which is neutral to income and expenditure in all countries would require some form of equalisation in charges and/or taxes in each.)
- A new lower rate of VED of £160 would raise £4.2bn pa, enough to fund total spend in England.
- But to gain access to the full network at all times, drivers would have to pay the new £200 standard rate (or a higher level if the spread of access it opens up is sufficiently broad).

We could expect a majority of drivers to stick with that standard rate, and not seek to slip back to the £160 discounted rate barring them from the restricted access stretches. Based on the high take-up of a motorway vignette option in eg Austria we suggest that around 80% (21m vehicles) - would opt to pay the full £200. That would generate extra revenue of over £800m pa, a very respectable seedcorn for raising finance for major enhancements by new operators of the SRN / PRN. With an all-in financing cost of 8% pa, this could service total new investment capital of c£10bn.

(ii) Stage 2: VED replaced by a suite of Road User Charge options

Investment in enhancements must not be restricted to the premium stretches: improvements elsewhere on the network would justify the discounted level of VED also rising in real terms. But any increases in VED receipts would still be exceeded by the expected falls in Fuel Duty receipts, so Government could confidently guarantee that a motorist's total tax payment would not rise in real terms. <u>Once drivers become familiar with the operation of usage-related VED, it would make sense for the payment to switch from being a tax to a charge levied directly by the Roads Trust for the service provided by the road network</u> – comparable to the transition from water rates to water charges[4]. This new Road User Charge (RUC) would be subject to VAT; securing that extra revenue for the Exchequer would still not breach the guarantee on the bill for the motorist. With the Trust no longer funded from taxation, it should be easier to for it to be classed alongside the road operators as private sector for ONS purposes.

[4] The water industry provides an attractive model in some respects, but roads brings in many more complications: consumers only contract with one out of the ten water companies, whereas a driver would need access to the service provided by several road operators. That provides a further rationale for inserting the Roads Trust as the intermediary with whom the user has the contract.

By this time the Trust has gained public confidence and will be trusted to deliver, through the operating entities, specific enhancements on agreed timetables. With its greater commercial focus, the Trust can offer a range of more sophisticated service packages than was possible under the constraint of VED, whilst sticking to the principles of monthly payment and discounts for access dispensed with, rather than premium for privilege. For example, if the driver agrees to carry some GPS capability, perhaps on a smartphone, then he could demonstrate in more detail than through ANPR camera reads where he had been driving and how far he is entitled to lower levels of RUC.

It is important to recognise that making changes in VED or its successor RUC in return for varying service from the SRN tackles only a small part of the total proposition for the motorist, what he pays out and what he gets in return. We will need to develop ways of extending the logic of this reform for the SRN to local roads, which play a far bigger part in everyday driving. If Local Highways Authorities were to follow suit in vesting their network in a ring-fenced entity, there could be a simple top-slicing of VED collected at national level to feed such a structure, but it is difficult to enhance this by incorporating some form of local accountability. It is only by the time users are paying charges in Stage 2 that we can effectively embrace local as well as national roads. The Roads Trust could for example through its packages allow drivers to opt out of specified peak driving on roads run by groups of adjoining LHAs, going beyond the Trust's own responsibilities for the PRN.

This mutation of VED into a Road User Charge therefore provides an attractive way of moving towards a platform of road pricing, through incremental changes rather than a Big Bang, and through incentivising rather than penalising drivers. With only a limited network of ANPR cameras needed, and drivers increasingly opting to equip their own GPS capability, the set-up and running costs of the system should be much less than had been estimated in work under the last Government following on from the Eddington model, and they would be dwarfed by the potential economic gains from charging a fairer price for our road use.

These reforms ought also to take account of the other main costs faced by motorists, notably *insurance* and *driver training*, which together constitute an increasing barrier to young people needing flexible transport (and to the skills base needed by the economy). The Roads Trust might be empowered to take a more holistic approach to the investment needs of the roads sector, and allocate some of its budget to support driver training, perhaps through bursaries for candidates in lower income groups. And it should take a lead in advocating the legal and technical changes needed to drive down insurance costs.

This package of reform will need to sit alongside the separate lorry charging scheme planned to come into force in the current Parliament. The Roads Trust will have to take account of the needs of freight users, but with the primary scope set as car and van traffic, the crucial task of preparing a presentation strategy can focus on private users of the roads.

5. Making this an acceptable proposition

It has been essential from the outset to ensure that the reform package is one that could easily be bought by the public. The Prime Minister said in his March speech that he will not shy away from difficult decisions, even at the expense of short-term unpopularity; that might strengthen the resolve of Ministers in launching a programme of change in this highly sensitive area, but they will need to see a path that they are comfortable with. There is a great deal of experience to help us draw up this path: certainly from the failed attempts to warm the public to national road pricing and to press on with local charging schemes, but also more helpfully from models of successful change in water metering and other utilities pricing packages, including mobile phones.

ITC is keen to draw on its technical expertise and its objectivity to advise Government in a next phase of work finessing this reform proposition to maximise buy-in across society. Initial soundings this summer indicate people would be surprisingly receptive to change in paying for roads – if this were seen as fair, promoted safer and greener driving, and gave users a say in where their money should go. In building on that, we intend to focus on five key considerations in a successful presentation strategy:

- *Promoting strongly the benefits, for all, of good roads.* The core motorway network has been a given for several decades now, and with the policy focus shifting to what can best use the roads, Britain has come to take the road infrastructure itself for granted. But better designed and managed roads can make an immense difference to the efficiency and safety of all types of movement, from deliveries, through cycling and bus journeys to work, to the leisure driving essential for rural economies. It is worth seeking to convince the public that they shouldn't tolerate the sub-optimal in congestion and casualties, and that a programme of investment in roads – including bypasses for communities that want them - will build in valuable incentives for safety as well as performance.
- *Highlighting the benefits of increased accountability and of a user voice in roads provision.* The public are all also the users of roads, and yet there is a striking absence of any meaningful consumer representation, at odds with all other sectors where public money is involved. Personal transport by road takes up 11% of all household expenditure, more than is spent on food[xvi]. A large proportion of that is in tax, yet little effort is made to explain where that goes. Setting up transparent user charges flowing to road operators with clear responsibilities and visibility to users would begin to address motorists' perceptions of being taken for granted, helped by penalties for operators if they fail to deliver acceptable service. Significantly, it should also increase public acceptance that good roads need to be paid for and so their bills may have to rise in future.
- *Using astute marketing in devising new ways of funding roads.* The prolonged debate around road pricing has made the idea of additional payments for road use more rather than less inflammatory. In side-stepping that and extracting the necessary funding from the existing tax collection mechanism as we propose, we can take advantage of the murkiness of current tariffs to force through a simpler structure which offers discounts rather than charging premiums. It

weakens the accusation that the better off can simply buy privilege, and avoids the need to wriggle out of the commitment not to charge for using existing roads were Government to proceed to levy a toll for using roads such as the A14. And switching the standard presentation of VED to a monthly cost would align its perception with that of mobile phone and other commercial services.

We argue it is better to manage reform of this sort as a national issue on which the public can express their opinion through the normal Parliamentary cycle, rather than risk the concept of charging gathering momentum as one local controversy after another, each with clamour for a referendum. And there would be presentational advantage were Government to be bound by a cap, set for each Parliament, on the total level of motoring tax year by year. This could form a key element in a commitment that this reform only entails increasing the cost of driving where there is a clear service improvement in return.

- *Stressing the Trust element of the proposed structure.* The public are far more open to change if they feel they can trust the bodies that drive it; and they can be suspicious of unfamiliar private companies whose motives they fear conflict with their own. The ring-fenced structure is designed to attract international investors in infrastructure, but adding to it an effectively governed Roads Trust as the overseer should send a strong signal that the public's interest will remain paramount. It would be ambitious to expect the Trust to match the levels of respect enjoyed by the likes of the John Lewis Partnership or the BBC, but it would be more directly accountable to the user than the closest precedent, Network Rail. As user confidence in the Trust builds up, the more sophisticated the payment packages it will be able to market; an interesting precedent is provided by Oyster, whose holders are comfortable with complex pricing structures because they now trust the brand.
- *Recognising that there will be some losers, but that fairness will run through every aspect of the reform.* There is a large body of work on the sectoral impacts of road pricing proposals, including detailed work by the ITC in 2006[xvii]. We noted then that user charges higher than we are proposing here, sufficient to fully replace Fuel Duty, would transform travel in suburbs and cities and bring big economic gains, but at the expense of more traffic and environmental damage on country roads. Even with our more modest proposal, any attempt to bring in a fairer system of paying for what you get will hurt some people. The detailed design of the initial discount regime will be key to ensuring that it does not just hit occasional, low-income drivers around the conurbations, or become a bargain-rate carte blanche for intensive users of the congested motorways. Rural drivers well away from the bottlenecks on the network would benefit, and that will be seen as fair. We will also need it to be seen as fair for suburban motorists to have to pay more, in return for a better experience on an improved road. This is clearly an aspect where we need to revisit our 2006 work and build up the evidence base first before attempting to fine-tune the messaging.

6. Conclusions

This package should deliver:

- a management tool for our key transport network which can reduce congestion, spread peak loads, optimise existing capacity and improve road safety; and
- a regulated utility regime which can secure substantially increased investment in the network

In combination, this constitutes an important contribution to economic growth in the medium term, with the potential as a result for increased tax revenues

And alongside, the package also provides the basis for much stronger accountability to the road user, which should smooth the process of reform. If the analysis that ITC and others currently have under way does confirm that we have indeed reached 'peak car' use, with the demand from each of us finally stabilised, then it is all the more important to put the deal for the motorist on a more contractual basis: a given level of service in return for transparent costing, with all of us paying our way just like other commercial services. There is probably no longer a rising tide of traffic threatening to engulf the country, and no case for harsh counter measures. The total volume of traffic might still be expected to rise, along with every other sector of a growing economy, but the policy response just needs to be effective charging, introduced in a sensitive way that avoids reigniting the passions generated hitherto by the 'great car debate'.

7. Next steps

ITC applauds the Government's action in tackling this major area of public policy and its readiness to engage with external partners. We urge Government to use this opportunity to map out a trajectory towards more comprehensive reform of how we pay for road use. We are keen to continue feeding in to what will clearly be a major programme through to the end of this Parliament and beyond, and to help formulate the necessary longer-term vision. While awaiting the outcome of the Feasibility Study we plan a seminar later this autumn to test the extent of common ground with other key partners on the direction of reform.

We will welcome indications from Government of the priority areas in which further ITC input could be most useful. For the time being, alongside the work on building a consensus, we intend to major on developing the arguments around public acceptability, with the emphasis on securing the support of the public as citizens, rather than just as motorists. We will also investigate the public accounts status of the Trust concept, and, looking more broadly, will ensure that we take account of the likely impact of this reform on other modes and on journey choices.

Independent Transport Commission

Registered Charity 1080134

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i ‘Keeping the Nation Moving’, p13, RAC Foundation, November 2011

ii TSGB tables TRA0102b and RDL0203

derived from Transport Statistics GB 2011; Faits et Chiffres - Statistiques des Transports,

iii Union Routière de France, October 2010; and Bundesanstalt für Strassenwesen, October 2011

iv speech to Institute of Civil Engineers, 19 March 2012

v ‘Keeping the Nation Moving’, p28

vi IAM analysis, August 2011

vii ‘Road Pricing and Road Investment’ ITC, November 2006, and see Annex C to this paper

viii 46% of households in the lowest three income deciles own a car or van (Family Expenditure Survey, 2010)

ix Governing and Paying for England’s Roads, RAC Foundation July 2010

x ‘A Fresh Start for the Strategic Road Network’, DfT, November 2011

xi comparing average driving costs of 4.2p per km from Fuel Duty at 58p/litre with c1p cost in CO2 per km using the DECC non-traded carbon value of £56/tonne (cited by ‘Fuel for Thought’, IFS, May 2012)

xii ‘Moving On’, RAC Foundation Think Piece, November 2011

xiii £5.2bn pa collected from the 31m private and light goods vehicles registered in the UK

xiv up to £460 pa, with up to £1,000 payable in the first year of registration; part of the simplification of VED would entail dispensing with that ‘showroom tax’ complication.

xv Indicative figures only, drawing on published Spending Review and related statements, [and unpublished DfT study 2009].

xvi ONS Household Expenditure Survey 2010

xvii ‘Paying to Drive’ and ‘Road Pricing in Great Britain: Winners and Losers’, both April 2006

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