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Political Economy of Road Pricing: A Case Study of the M6 Toll
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Regulation of Corridor Pricing: Complementary Notes¹

1. Philosophy of Regulation

It has been argued over the past 30 years by many legal philosophers that legal decision-making and the evaluation of legal rules should be guided by the goal of economic efficiency. The standard definition of efficiency followed the Kaldor-Hicks test, or wealth-maximisation test: a legal change is efficient if the gains to the winners exceed the losses to the losers, or in other words, if the wealth of society is increased. The wealth maximisation principle embraces the idea of an ideal market, a laissez-faire state with very little or no regulation. As a normative theory of law, the wealth maximisation principle departs from the point that self-regulation by the market is the de facto most efficient system of control, and the best route to wealth maximisation. However, where the market operates inefficiently, the theory condones interference with economic and personal liberty, and the legal coercion this entails. As such, where self-regulation is obviously failing to produce an efficient market, compelling arguments can be made for the government retaining some influence and control over market behaviour.

In an attempt to improve efficiency many governments have implemented economic reforms over the past 20 years that demanded deregulation of public's activities, and which have allowed the market system to flourish. However, instead of eliminating the need for regulation, such reforms have emphasized the need for effective regulation and regulatory institutions in order to achieve the correct level of efficiency. This need in the transport infrastructure sector is due to the existence of natural monopolies, the limitations of competition for the market, the existence of asymmetric information between transport operators and regulators, the need for private investment in infrastructure facilities, and the need to assign risks between operators and the government in a most efficient manner.²

It must be noted that it is one thing to talk of economic efficiency as an objective of economic policy, but the laissez-faire approach to economic policy tends to ignore the protection needed for continuous efficiency to endure, thus overlooking the imperfections of the market on a global scale. It is the function of regulation to promote interests and, as such, it necessarily needs to be imposed on market imperfections.

¹ Credit to Ana-Katarina Hajduka, Associate FULBRIGHT & Jaworski Int. LLP

² United Nations, Economic and Social Commission for Asia and the Pacific (the Economic Regulation of Transport Infrastructure Facilities and Services) Principles and Issues

The above statement is not meant to argue against the idea that an appropriate and free market structure is necessary. However, the argument is that this is not a sufficient condition for a market to succeed. The challenge is to provide the appropriate boundaries by crafting regulation that is flexible, minimal and not intrusive but is still comprehensive, responsive and effective.

2. Private Sector Participation in Transportation Projects

As a result of fiscal challenges and the lack of dedicated public funding sources for transportation infrastructure, the transportation agencies around the world, in particular in Western Europe have developed and applied alternative ways to finance and deliver the required transportation infrastructure. A number of countries have turned to the private sector for relief in the form of contractual Public-Private Partnerships (PPPs), representing a wide variety of project financing and delivery approaches to access capital markets, to implement new technology, and to expedite project delivery, operations, and maintenance in a more cost-effective manner. The common element of a PPP is that the public sponsor of infrastructure projects engages the private sector to a greater degree in the performance of certain functions previously handled by the public sector. Some countries have effectively turned over the responsibilities, risks, and rewards associated with performing these functions to private sector through long-term concessions or franchises, whose financing is supported by tolls, shadow tolls, or availability payments (a form of shadow tolls).

The success of private sector participation in delivering the expected efficiencies and social benefits depends on the introduction of appropriate incentives and effective transfer of risk to the private sector, as well as adequate reform of governance. While incentives and risk allocation are expected to unleash the efficiency of the private sector, the reform of governance, for example through the creation of an adequate regulatory framework, should safeguard the public interest and ensure a level playing field between the parties involved. Through the example of the M6 Toll Road in the UK it will be seen that private sector participation should be analyzed as a dynamic process with interaction among different actors pursuing different objectives. It is through regulation that the efficient and successful interaction among these different actors should be achieved.

3. The M6 Toll: Exposing Realities

The M6 Toll Road (formerly known as Birmingham Northern Relief Road) is a 27-mile (44 KM) long six-lane divided motorway bypass in the West Midlands conurbation. The M6 Toll Road connects at its northern end with the non-tolled M6 at a new junction north of Junction 11 near Cannock, Staffordshire. The route the M6 Toll follows is that of the existing road corridors of the A5, A38 and A446 passing through the counties of Staffordshire, West Midlands and Warwickshire connecting at its southern end with the toll-free M6 just east of Junction 4 at Coleshill, Warwickshire. The M6 Toll Road was built for £900 million and opened in 2003.

The M6 Toll Road was Britain's first privately funded tolled motorway, following closely the initiation of the national government-supported Private Financing Initiative for infrastructure financing and development in 1992. A 53-year DBFO concession contract was originally awarded in 1992. However, local opposition and legal maneuvering delayed project initiation for eight years, following the longest ever public inquiry for a road project. This was in large part due to the introduction of tolls and the determined opposition of nearby residents who would be paying the tolls. Most British citizens had become used to toll-free trunk since most new construction during the 1990s was financed by shadow tolls, whereby the Government reimbursed the project development team over time through what were essentially availability payments using general and transportation program funds without the users having any direct fees to pay to use the roadways.

Once the public opposition to the project was overcome, the concession team, led by Macquarie Infrastructure Group (MIG), which owns 100 percent of Midland Expressway Ltd (MEL), the concessionaire team for the M6 Toll Road until 2054, completed the project.

One of the major requests of the opposition to the project was to subject the M6 Toll Road to a cost benefit analysis in order to assess the economics of the project. The Highways Agency and MEL refused to do so claiming it was unnecessary. The Inquiry Inspector did not require one, claiming that it would not be built by a private company if it was not economic. The result was an asymmetry of information between the operator and the regulator and the confusion between the company's profits and the public interest.

As a result of the Concession Agreement the toll rate is completely at the discretion of MEL. This was also challenged at the public inquiry. The only caveat is that MEL can only change the rates on a six months basis. Unlike bridges and tunnels, where there is no alternative, it was assumed that free competition from the M6, the A5/A38/A446 and A50 would ensure that the MEL would not increase the toll too high and would act in the public interest. The argument of the opposition was that the inquiry did not take into account the fact that as the road begins to become congested with approximately 80,000 vehicles per day, MEL's commercial interests will be served by raising the toll and thereby discouraging traffic. The argument was that this is something that they are likely to do selectively, discouraging lorries (owing to road damage, safety concerns, speed) and concentrating on cars. Unfortunately, the lorries are precisely the vehicles that should be on the motorway network. Although the opposition persuaded the Inspector of their arguments on this matter, the Secretary of State rejected them.

What was being ignored at the time was that for business in the M6 Toll Road region, the flow of goods is a critical issue. The region has a strong manufacturing base which relies on just-in-time deliveries as part of its supply chain operations and in ensuring products are delivered at the right time to retail outlets. Eighty per cent of the landmass of the West Midlands for example is devoted to rural economy and therefore the effective movement of agricultural goods is particularly important for the region. Taking this into account and recognizing the importance of freight operations to the regional economy, the low level of HGV traffic on the existing M6 Toll Road should be of concern. This is in part certainly linked to the high toll charges that have been set. Due to that a light touch regulatory framework should have been

introduced to ensure that tolls were set at acceptable levels and that the rate of the toll road reflected the current market costs and the overall operating costs for the haulage industry. At the moment there is no legislation or regulation controlling what Midland Expressway can or cannot charge for the use of the M6 Toll Road.

According to press reports at the time the local business councils in the surrounding areas supported the new M6 Toll Road but the support was mainly predicated on addressing the following issues:

- capacity problems on the M6;
- the assessment of the impact of the toll road if national road charging is introduced;
- regulation of toll charges; and
- the need to ensure that the development of the project will not divert attention and resources in addressing road congestion in and around the conurbation.

Now after a number of years in operation it is increasingly clear that many of the aims listed above have not been achieved. Firstly, there are no clear signs that the capacity problems on the M6 have been improved, and on the contrary due to the high cost of the toll most of the freight traffic in particular has been transferred on to the M6. In relation to the second point it is unclear if there was any assessment of the impact of the toll road if national road charging were introduced. There is a possibility that all forms of road transport will be subject to national road charging in the UK. The Department of Trade and Industry have recently published a “Feasibility Study of Road Pricing in the UK”, suggesting that a national system of road pricing could be in place by 2014. The tolling of the M6 should not have been considered in isolation of any national strategy for motorway tolling or road user charging.

In terms of capacity, according to the BBC government figures the weekday use of the M6 toll is down year on year, with a drop of 10.6% from September 2006 to the same month in 2007. According to the Telegraph, Midland Expressway is laden with debt and has lost £80,000 a day during 2008.

4. Assessing the Realities

It can be argued that the M6 Toll Road did not achieve its purpose as auto traffic increased according to projections for the first two years only, while lorry traffic has significantly lagged behind expectations. Plans to expand the toll highway were cancelled due to high right-of-way costs, toll opposition, and lack of private sector interest given the performance of the M6. Widening the highway to 6-8 lanes has also been delayed 8-10 years.

There are three main instances of market failure: natural monopoly, externalities and asymmetric information. In considering whether to regulate, it is important to balance the market and its failings with regulation and its failings.³

From the information about the M6 Toll Road project above it can be argued that the general case for the use of regulation in this particular project is that a concession

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confers a long-term power on the concessionaire resulting in a natural monopoly, many externalities, and asymmetric information between the regulator and the concessionaire. The effectiveness of regulation and monitoring mechanisms was affected by the ability, or lack thereof, of local governments and communities to access vital information on the operations carried out by the concessionaire.

Finally, one of the problems with the market structure is the pricing structure on the M6 Toll Road. The concessionaire varies toll prices by time of day according to changes in the marginal social cost due to congestion. The reason is that the concessionaire has an incentive to make the road as valuable as possible to its users. However, the profit maximizing operator would add a markup to a marginal social cost reflecting the same consideration as a monopolist in any other market: namely, the less users are willing or able to switch to other options, the greater the markup.

These observations lead directly to two policy conclusions. First, private operators are likely to seek to implement innovative and beneficial pricing structures, but second, private operation should be accompanied by regulation to keep overall price levels from becoming excessive. The M6 Toll Road is a perfect example of an unregulated toll with the resulting high toll being criticized for undermining the road's congestion-relief goal.

5. Conclusion

To return to the principle of wealth maximization, it is clear that the M6 Toll Road is a classic example of where the market on its own has failed to produce the most efficient result. Whilst private sector participation provided the capital and met with initial success, the needs of the local economy and the consumer have been undermined, and the primary governmental objective of congestion relief has not been met. Rather than promoting greater efficiency in a competitive market where the interests of the concessionaire and the customer are aligned, the best interests of the participants have in fact diverged. The natural conclusion is that regulation and legal coercion – albeit as minimal and unintrusive as possible – are required to correct the imbalance and restore a properly functioning market.