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Funding our Roads: A better way

Brian Wadsworth
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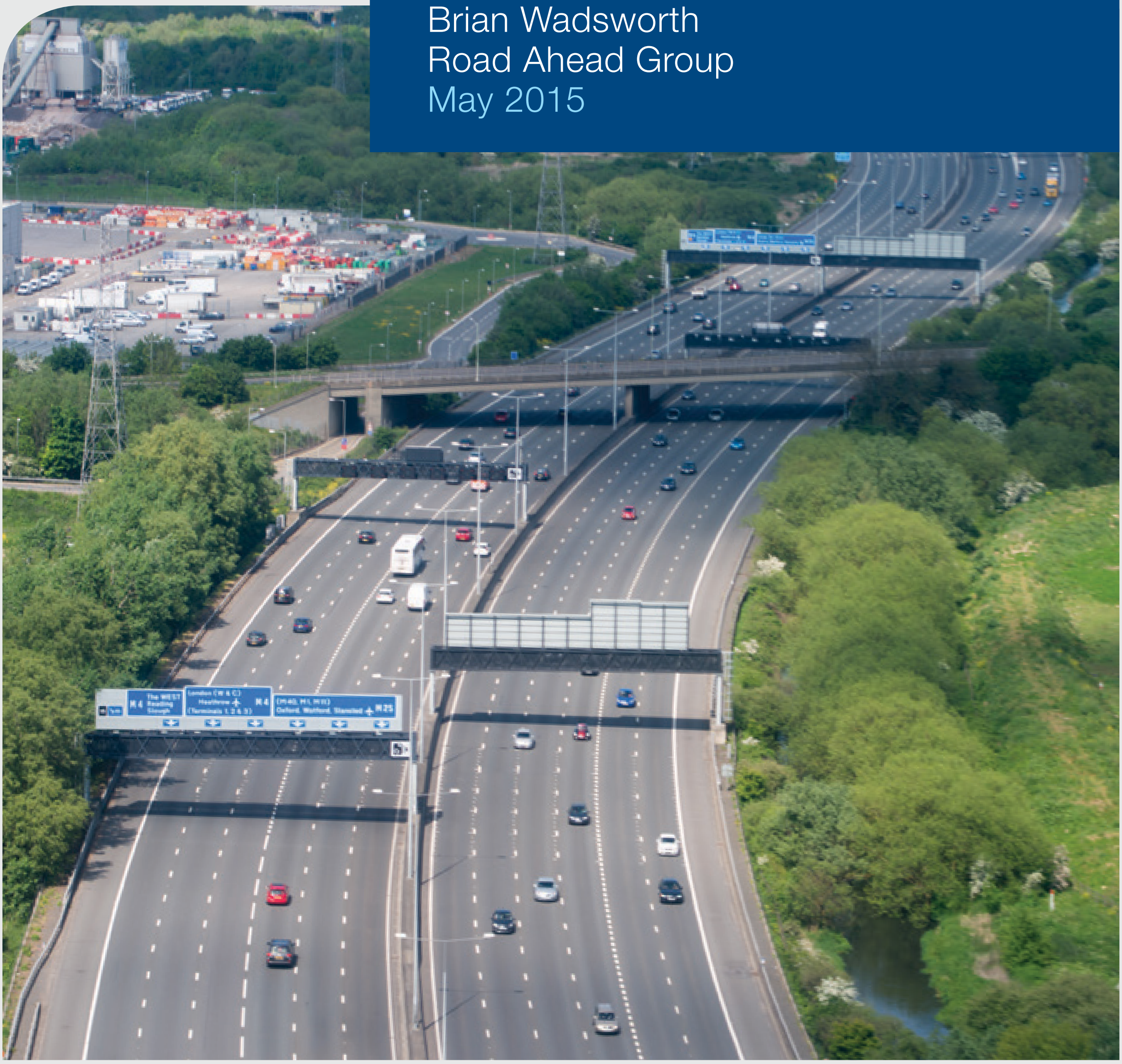
May 2015



The Royal Automobile Club Foundation for Motoring Ltd is a transport policy and research organisation which explores the economic, mobility, safety and environmental issues relating to roads and their users. The Foundation publishes independent and authoritative research with which it promotes informed debate and advocates policy in the interest of the responsible motorist.

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About the Author

Brian Wadsworth is Director of the Road Ahead Group, an alliance of private companies advocating reform of roads funding and motoring taxes. The Group's members include VINCI plc, Skanska UK, Amey, Ringway/Eurovia, Vinci Concessions, Berwin Leighton Paisner LLP and Interel UK Ltd. In October 2011 Brian's report Moving On: Fairer motoring taxes and investment for growth and jobs was published by the RAC Foundation.

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Disclaimer

This report has been prepared for the RAC Foundation by Brian Wadsworth, Director of the Road Ahead Group. Any errors or omissions are the author's sole responsibility. The report content reflects the views of the author and not necessarily those of the RAC Foundation.

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1. Introduction

Mobility of people, goods and services is the foundation of every developed economy. In Britain today, 90% of inland passenger and freight transport is by road. This proportion has remained broadly stable for many years and is not likely to change significantly in the foreseeable future.

A modern road network enabling safe, quick and reliable journeys is a key component of national productivity, competitiveness and long-term economic growth. Time spent sitting in traffic jams and missed appointments represent money down the drain. Yet although this is widely understood, road investment has been inconsistent – and, for years at a time, inadequate. Today, with a growing population and an improving economy, we are facing the prospect of mounting congestion, disruption and unreliability.

Whether to eliminate the budget deficit, reduce our national debt, or fund tomorrow's public services, above all else Britain needs healthy, sustained economic growth. Investing in roads is an essential precondition for this.

From the previous government we have inherited welcome commitments to treble the rate of spending on strategic roads, stabilise long-term planning and modernise governance. Highways England stands poised to take the helm and deliver. But a vital ingredient is missing. Funding remains at the mercy of successive Budget settlements, at a time when everyone recognises that balancing the public books will be exceptionally challenging. Without guaranteed, long-term funding, all we really have is plans, intentions and promises.

Road users today, through the taxes they pay, contribute four times the cost of running our roads. They deserve a better deal. Our country *needs* a better deal. It's high time to reform the way we fund our roads.

2. A Message from the Past

For decades, taxes raised from road users have gone straight into the melting pot of the Treasury's Consolidated Fund. Spending on roads has been decided in the annual round of Budget arithmetic. We've lived with this system for as long as any of us can remember: so long that our parents' generations – and in most cases those of our grandparents – have known no alternative.

A century ago there was a different system.

In his 'People's Budget' of 1909, Lloyd George (then Chancellor) introduced a tax we are all familiar with: Vehicle Excise Duty (VED) – then levied according to the RAC horsepower ratings of motor vehicles. He intended that roads should be self-financing and the proceeds from VED were ring-fenced to fund road maintenance and investment. From 1920 the term 'Road Fund' came into use and the tax disc was henceforth known as the 'Road Fund Licence'.

Although timely given the state of the road network at the dawn of the motoring age, this early example of tax linkage (known as 'hypothecation') was challenged from the outset. Treasury antipathy was predictable. Ring-fencing tax revenues constrains the balancing of Budget priorities. While roads could generate substantial tax income – thanks to the strong demand for motorised transport and fossil fuels to run it – very few other public services have connected tax revenues to draw on.

Winston Churchill strongly opposed the Road Fund. When Chancellor in the 1920s he is said to have declared, in a note to his officials, that reserving tax receipts from motoring uniquely and for all time for the benefit of those paying them was "an outrage upon the sovereignty of Parliament and upon common sense". He won the argument. Hypothecation of VED was ended by the 1936 Finance Act. By then the Road Fund was moribund, although it limped on in name at least until after the Second World War.

Motoring taxes have stayed with us ever since, through good times and bad. Their dogged resilience has been a boon to successive Chancellors and they have grown to make a very significant contribution to public finances. In 2015, revenues from motor fuel and VED combined will exceed total public spending on roads by a factor of four.

Churchill may have won the argument. But the passing years have revealed the long-term cost of his victory. Britain's growth has suffered, as short-term political and electoral imperatives have delayed or trimmed back investment in efficient road communications. Perpetuating this approach has not benefited the NHS, public education or other public services, any more than it has served our personal mobility needs or built material prosperity. In the long run, good public services depend, above all, on sustained economic growth. Road investment has been miscast as a competitor in the perennial Budget tug of war, when in truth it helps to make other Budget priorities more affordable.

3. Why Reform is Needed Now

Adjusting public finances is never easy. Changes trigger suspicion, especially when the status quo has lasted for as long as anyone can remember. They often create winners and losers. Tax cuts, like eaten bread, are swallowed and forgotten. Tax rises are remembered – and resentment lingers.

This report is *not* about whether motoring taxes should be raised, reduced or kept the same. As Churchill rightly said, this is a question for governments and for Parliament. The right to tax is fundamental to the very existence of government and all the public services we rely on. We do not argue that motoring should be exempted from taxation, or made a special case.

The issue addressed here is narrower. Should *part* of the revenues raised from motoring taxes be earmarked for spending on roads? For 80 years now the answer has been "no". Present circumstances demand an urgent rethink.

Building Britain's recovery

The scars left by the longest and deepest economic recession in modern times are still fresh. As in previous economic downturns, public investment and asset maintenance bore the brunt of emergency spending reductions at the outset of the previous Parliament. Since 2009/10, road capital spending in England has fallen by over 13% to £4.2 billion, while current expenditure fell 34% to £2 billion (DfT, 2015a). 'Twas ever thus: optional, uncommitted expenditure is the easiest item in any Budget to cut. Postponing projects not yet started causes the least pain. Potholes can be left another year, or two, or…

But as Britain's long haul towards recovery began, political perceptions and priorities evolved. Ushered in with a period of severe cuts in capital spending, the Parliament of 2010 to 2015 saw the emergence of a strong cross-party consensus in favour of sustained investment in productive economic infrastructure, to support economic recovery and growth.

As far as roads are concerned, the emerging consensus found substance in the July 2013 government Command Paper *Action for Roads: A network for the 21st century* (DfT, 2013). This announced major reforms to planning and governance for national roads, including:

- greater commercial freedoms for the Highways Agency, to be reconstituted as a wholly owned government company (in the event it became Highways England), subject to specified remits, accountabilities and controls;
- a five-year statutory planning process for national roads, paralleling the system established for rail, with a Road Investment Strategy setting out delivery commitments and targets;
- a commitment to treble capital spending on national roads by 2021, with £6 billion more being made available for local roads maintenance;
- a vow to drive down Highways England's supply costs, thanks to efficiency gains from more consistent and stable demand; and
- the establishment of an independent efficiency and performance monitor for the roads sector, as an arm of the Office of Rail and Road (ORR), and a road users' 'watchdog', under the wing of Transport Focus.

These reforms attracted broad cross-party support, at least at a strategic level. They were given substance by the Infrastructure Act 2015, one of the final pieces of major legislation to be enacted by the last Parliament.

Something missing

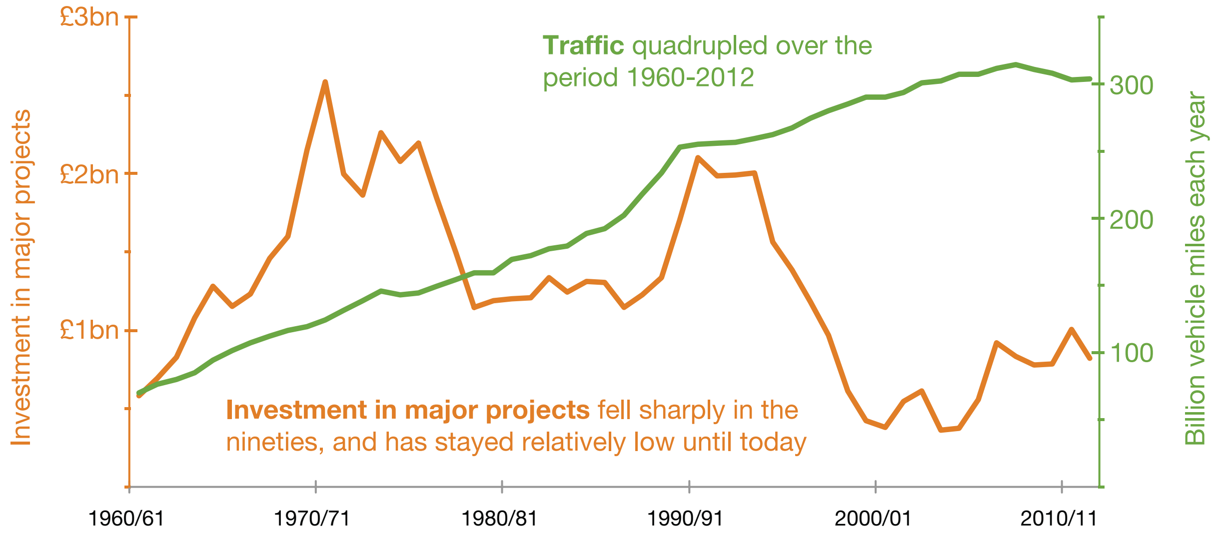
Sadly, *Action for Roads* did not deliver one crucially important reform.

There is still no permanent, dedicated funding stream for national or local roads. It is down to each Chancellor, each government and each Parliament to decide how much (or how little) to invest.

As MPs on both sides of the House observed during the passage of the Infrastructure Bill, one Parliament cannot commit the next, nor should it presume to do so. This is indeed a basic principle of democracy. All governments have the right to change what they inherit. But when it comes to roads we have all the evidence that we need to prove where this leads.

As Figure 3.1 (published in *Action for Roads*) reveals, public spending on roads has fluctuated wildly from year to year and from decade to decade, undermining long-term planning and delivery. One need only look back as far as 2010 to identify the last time a Chancellor had to slam the brakes on road investment in response to an economic shock.

Figure 3.1: Traffic and spending on trunk road schemes



Source: DfT (2013: 15)

The last government intended *Action for Roads* to mark the start of a new era of lasting stability and consistency. The first five-year Road Investment Strategy (RIS), published before the election, does indeed promise a step change in spending and delivery. But without protected, ring-fenced funding, nothing can be taken for granted.

Funding risks

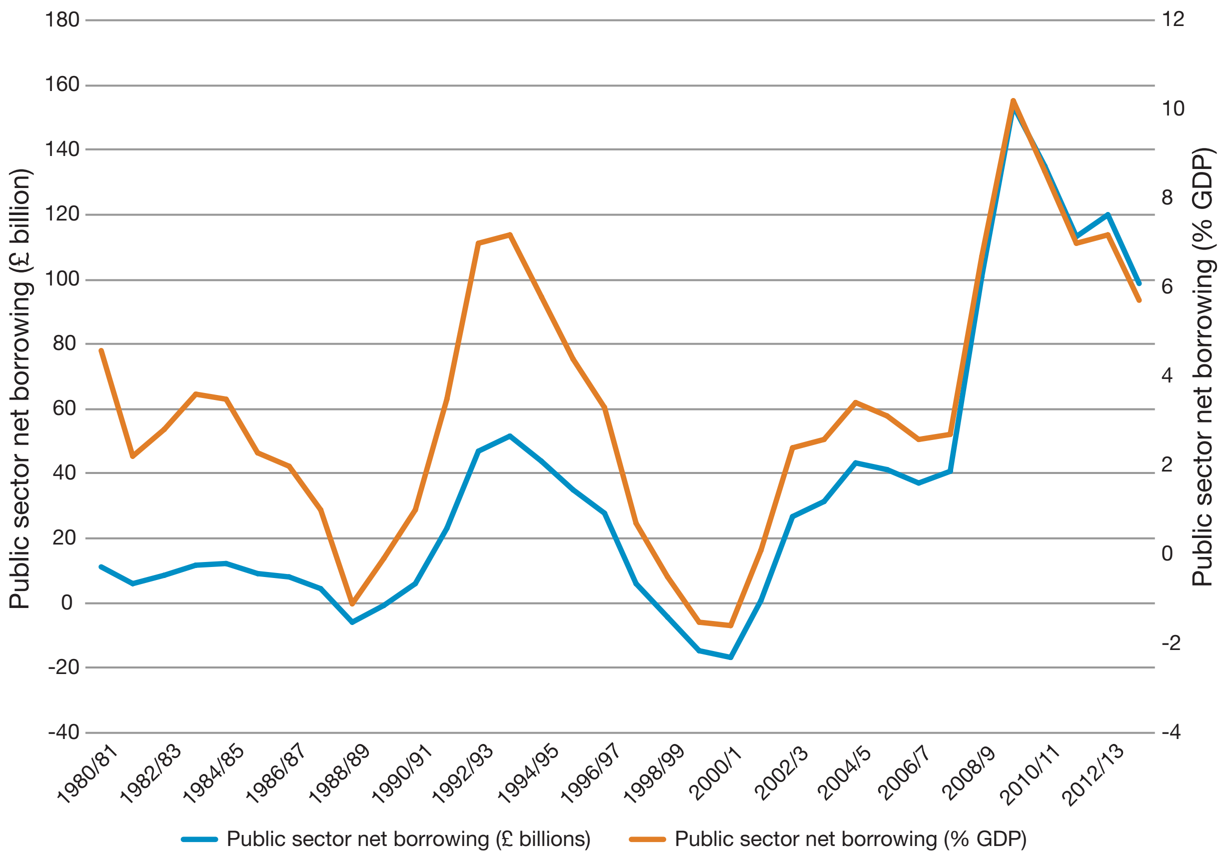
Looking ahead to the new Parliament and beyond, there are two glaring and substantial risks to the delivery of the RIS.

The fiscal challenge

The fiscal challenge facing the new government is widely recognised. According to figures published by the Office for Budget Responsibility, the UK government's Budget deficit quadrupled between 2007/8 and 2009/10, reaching a peak of £157 billion, or 11% of GDP (see Figure 3.2). Five years later public spending still exceeds government revenues by an uncomfortable margin.

It is widely acknowledged that merely eliminating the annual Budget deficit will require tight restraint of public spending throughout the new Parliament and possibly beyond. Cuts will bear especially heavily on non-protected departments, given the key spending pledges made by the main political parties. Transport has not been identified as a protected programme.

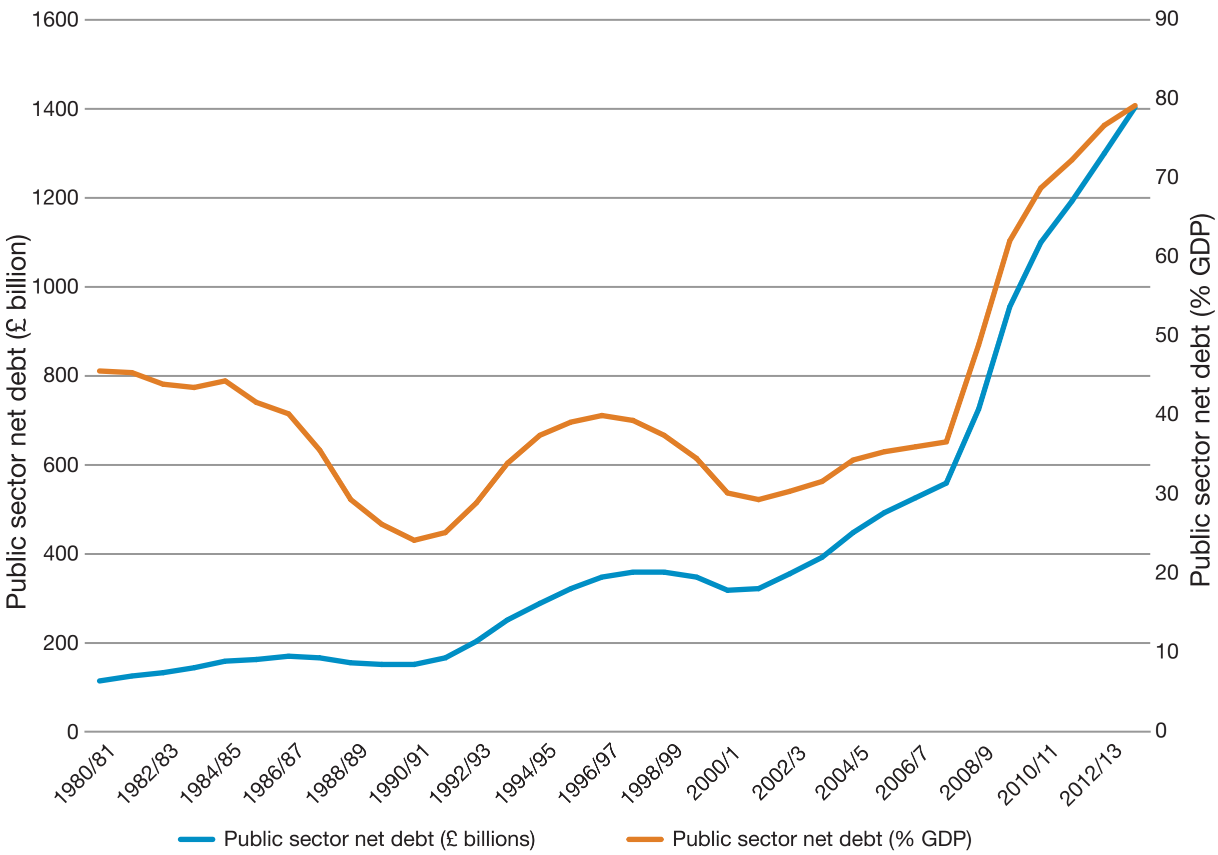
Figure 3.2: Public sector structural deficit



Source: ONS (2015)

There is more to the fiscal challenge than eliminating the annual spending deficit. As Figure 3.3 shows, between 1980 and 2007 our national debt hovered at around 40% of GDP. By 2014/15 it had ballooned to 80.4% of GDP.

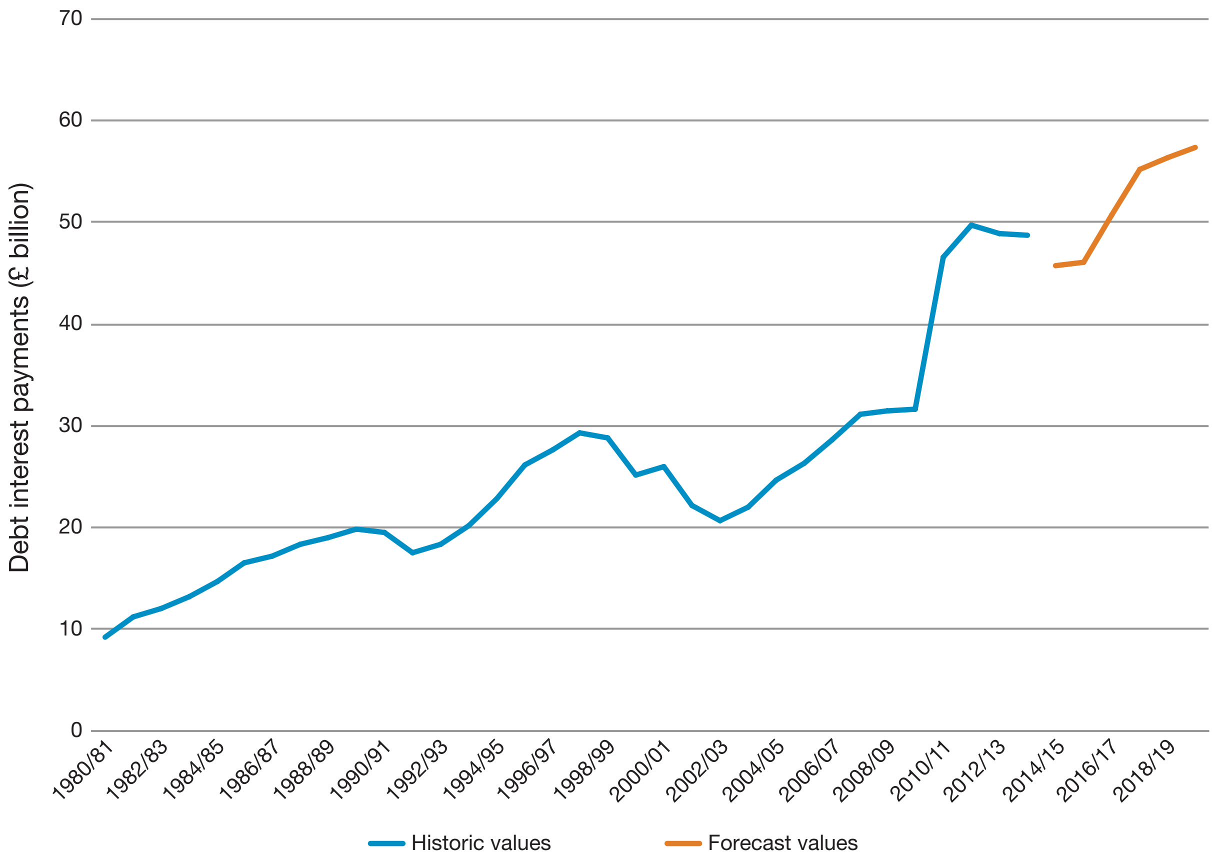
Figure 3.3: Public sector net debt



Source: ONS (2015)

Government debt interest payments (Figure 3.4) – unavoidably the first call on the public purse – will rise to over £57 billion a year by the end of the new Parliament. This is nearly £30 billion a year more than before the financial crisis. To put this in perspective, the *rise* in debt interest payments amounts to *three times* what central government spends on transport (for all modes). In the last year of this Parliament the government will have to find £10 billion more just to service our national debt than at the start.

Figure 3.4: Debt interest payments



Source: ONS (2015)

Given this fiscal 'double whammy', can we *really* believe that long-term road investment plans will survive without dedicated, guaranteed funding? It will take a very brave Chancellor (and government) to protect spending on roads at a time when budgets for health, education, social services and so many other big spending programmes will be under intense pressure.

The spending challenge

In fact, the challenge that the new government faces goes well beyond just 'protecting' public spending on roads.

If the new government wishes to deliver the ambitious investment plans developed during the last Parliament, money will have to be found for High Speed 2, rising to £4.5 billion a year by 2020 (Table 3.1). On top of that comes the promised trebling of spending on roads needed to deliver the first RIS.

These two programmes alone require the spending of £5.2 billion a year (on average) from 2015/16 through to 2020/21. In 2015 the budget for both programmes stands at less than half this level.

Table 3.1: Government's long-term spending plans

£ million	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	Total
High Speed 2	832	1,729	1,693	3,300	4,000	4,498	16,052
Highways Agency	1,497	1,907	2,316	2,614	3,047	3,764	15,145
Network Rail	3,548	3,681	3,770	3,789	3,824	3,859	22,471
London Transport Investment	925	941	957	973	990	1,007	5,793
Local Authority Major Projects	819	819	819	819	819	819	4,914
Local Authority Maintenance	976	976	976	976	976	976	5,856
Integrated Transport Block	458	458	458	458	458	458	2,748

Source: HM Treasury (2013: 8)

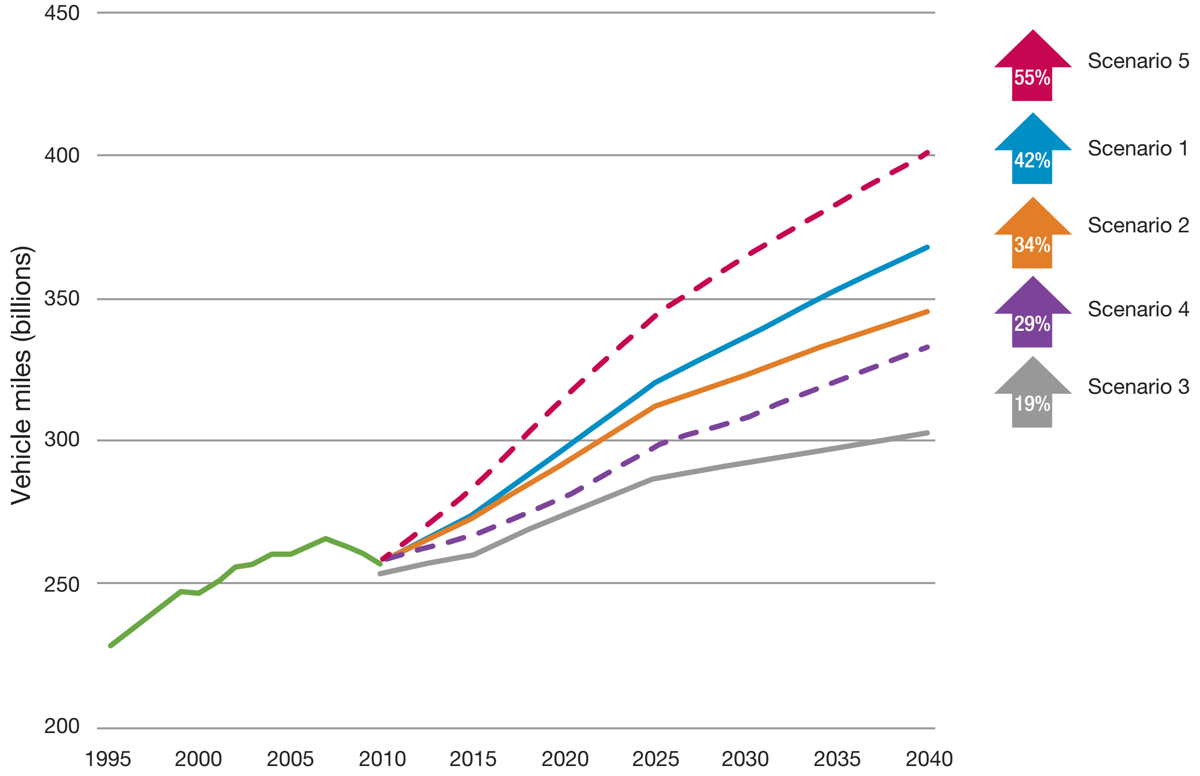
This is personal

It is evident that without funding reform, the risks to long-term investment in our road network are acute. Indeed, they have seldom if ever been greater.

This problem matters to each and every one of us.

In March this year, the Department for Transport (DfT) published a new set of long-term road traffic forecasts (Figure 3.5). Having revisited forecasting methodology in the light of recent trends, DfT's latest modelling broadly confirms historical experience in the long run. As Britain's economy grows, so will road traffic.

Figure 3.5: Traffic growth by scenario (billion miles, all vehicles)



Source: DfT (2015b: 39)

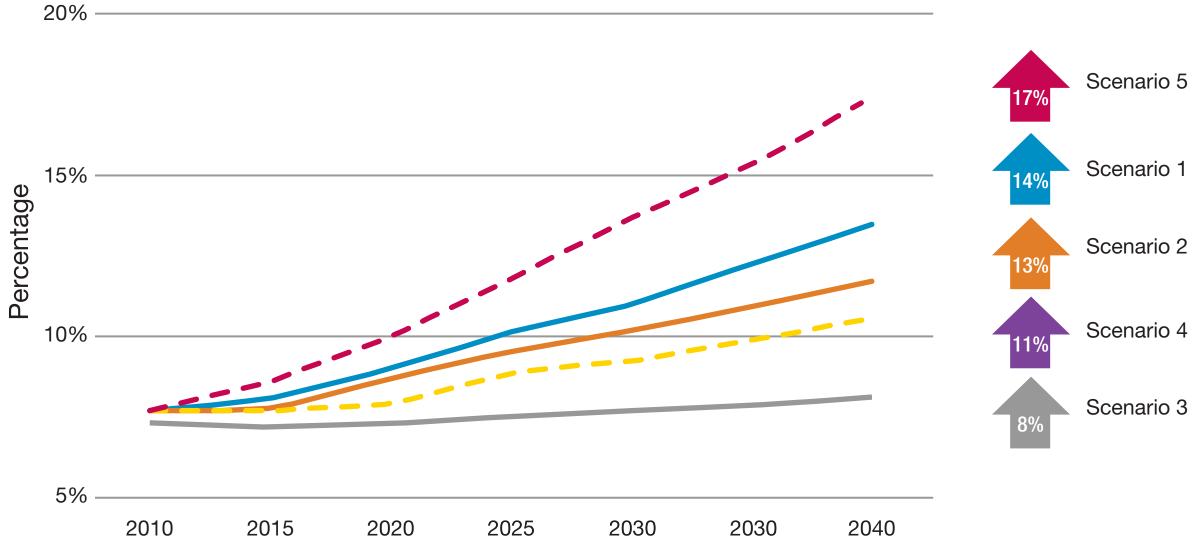
Even under the lowest economic growth scenario, traffic on our roads is projected to rise by nearly 20% over the next 25 years. DfT's high-growth scenario projects a 55% increase and the median forecast is an increase of one third.

For the sake of our children's prosperity and the public services they will rely on, we should all be hoping for an outcome in the median-to-upper growth range. The implications for mobility must be squarely confronted. Even if *all* the road investment plans set out in the first RIS are delivered on time, the latest traffic forecasts still predict a very significant increase in road network congestion. This is shown in Figure 3.6, which is taken from DfT's report (DfT, 2015b).

What is left unsaid is clear enough. Should the promised increase in road investment *not* materialise (or fail to be sustained), we shall face something close to chaos on our roads.

And that's just the start. Britain's productivity, competitiveness and future growth will suffer mounting damage from an underperforming road network. In the long run this will mean less money to fund the whole range of other public services, from education to health to defence.

Figure 3.6: Congestion (proportion of traffic in congested conditions)



Source: DfT (2015b: 40)

Road investment which does go ahead will come at higher cost to all of us. The previous government set Highways England a target to find £1.2 billion of supply chain efficiency savings over its first five years (DfT, 2014a). Achieving these savings relies on supply sector investment, triggered by solid confidence in long-term business prospects. We have a steep hill to climb in that regard. Our highways supply sector bears deep scars from years of instability. Major suppliers can clearly see the risks to future funding in a difficult fiscal context. Genuine, lasting confidence to unlock efficiency savings will *only* come from permanent reform of funding. Nothing less will suffice.

The time is right for change

Timing isn't just about risks. It's also a matter of opportunity.

Today there is strong cross-party support for investment in Britain's infrastructure, to a degree that we have not seen for many years past. The last government's commitments to stabilise long-term planning for roads and boost investment were widely supported. The new government has an ideal opportunity to translate this consensus into action, by *guaranteeing* funding for roads, once and for all. We must seize the day.

4. A New Road Fund for a New Century

Creating a permanent, dedicated fund for roads need not be difficult. The simplest way to launch it would be by ring-fencing government receipts from VED – exactly what Lloyd George did over a century ago.

The money is there. VED currently raises £6.1 billion a year (DfT, 2014b). Government spending on national roads is currently £3 billion a year (DfT, 2015a). A new Road Fund could pay for national roads at present levels of VED. It cannot be denied that VED is a payment exacted from motorists in return for the privilege of using the public road network, but for decades successive governments have repudiated any linkage between VED and funding for roads. In order to create a modern Road Fund, the government has only to acknowledge the evident linkage instead.

Of course, when it comes to the detail there is more to it than this. But although there are choices to be made, there is no practical show-stopper. Establishing and running a Road Fund is eminently feasible – and could in fact be done quite quickly. There need be no radical (or even significant) change to the present level or structure of VED, or the way in which it is collected or enforced.

Safeguards can and should be put in place to ensure that the Road Fund is managed and spent efficiently. Such a Fund should have a statutory basis and its detailed administration should be divorced from politics. ORR, acting as a sector regulator, should review Highways England's spending plans at regular intervals and assess the adequacy of the Fund against appropriately challenging efficiency targets, assuring value and fairness for road users.

5. The Benefits of a Road Fund

The benefits of creating a new Road Fund would be profound. Five of the most important challenges are summarised below.

Securing delivery, supporting growth

New roads and major improvements take many years – indeed decades – to plan, design, take through the public consultation and planning processes, and ultimately build. A Road Fund would guarantee long-term funding through good times and bad, securing the delivery of urgently needed enhancements to road network capacity and performance. It would cement the promises made in the first (2014) Road Investment Plan, and in future five-yearly strategic plans.

Guaranteed delivery of network improvements, year on year and decade after decade, would boost Britain's productivity, competitiveness and growth. This is the most important benefit of all. It would accrue to everyone: government, road users, citizens and taxpayers and all of us who rely on the whole range of public services.

Enhancing accountability

Consistency of planning and delivery would transform accountability. It would become feasible to set strategic targets for road network performance and monitor progress towards their achievement. This would be a giant step forward. No longer would the vagaries of stop–go funding afford a perennial (and legitimate) excuse for delays, inefficiencies and failures to deliver. All of us, as users of the road network, would be clear about Highways England's long-term service promise. There would be a clear and rational basis for judging the adequacy of future investment plans. Highways England would be firmly held to account for delivery.

Enforcing performance

A Road Fund would make roads regulation real. ORR would have clear and enduring strategic delivery milestones against which to judge Highways England's performance. There would be no ambiguities, qualifications or escape clauses. The level of funding required to deliver agreed capacity and service levels would be transparently vetted by ORR and agreed in the public domain. Efficiency targets would be locked in, safeguarding taxpayers' interests.

Empowering road users

A Road Fund would make a reality of consumer rights and consumer protection. For far too long, well over 30 million road users have been left at the mercy of a volatile policymaking and planning process. Diverting an element of motoring taxes into a dedicated Road Fund would give road users genuine customer status for the first time. Customers have rights, which regulators and consumer watchdogs can champion. Taxpayers, on the other hand, are simply obliged to hand over the money.

Building a strong supply chain

A dedicated Road Fund would transform our highways supply chain. Repeated stop–go cycles have cost jobs; inhibited skills development; damaged investment in technology, plant and machinery; and eroded productivity. A dedicated Road Fund would replace chronic uncertainty and volatility with long-term stability and justified confidence. (A Road Fund is in fact the *only* way of achieving this.) From a supportive, reliable platform of domestic demand, British companies would be better placed to expand their business overseas, expanding British exports and creating jobs.

6. A Better System for Road Users

It's time we all acknowledged the truth. Roads aren't 'free'. They never have been, and they never will be. We all pay for them, out of our own pockets.

As stated earlier, VED is nothing more nor less than a payment we make to the government in exchange for our mobility. The government imposes a legal requirement on every vehicle's keeper to pay the designated level of tax, if that vehicle is to be used at any time and to any extent on the public road network. Enforcement, supported by penalties, ensures that untaxed vehicles are detected and evasion is prevented.

Refusal to connect VED to funding for roads is handy to Chancellors under pressure to balance the books. But it has been bad for road users. VED is an arbitrary levy, an expedient creation of government policy and legislation. The amount motorists are obliged to pay can be changed at will. There is no need for any Chancellor to justify the level or structure of VED, nor explain any changes made to it, by reference to any objective rationale or criterion. It is just a balancing item in the Budget arithmetic.

Establishing a Road Fund would change this for good:

- The level of VED would be determined by the quantum of funding required to maintain and improve the road network. There would be a clear rationale, putting an end to sudden or arbitrary changes in the rate.
- VED would be further stabilised through linkage to the five-yearly Road Investment Strategy (RIS). ORR would be an independent, public 'umpire', ensuring the adequacy of the Fund at the same time as safeguarding fairness and value for road users.
- As pointed out earlier, a stable RIS, supported by a Road Fund, would enable the setting of firm, long-term network performance standards.

Instead of receiving nothing for their VED payment beyond a right of access to the existing road network, motorists would instead have the benefit of clear and meaningful service improvement commitments from the network operator, with delivery being closely and publicly monitored by ORR and the consumer watchdog.

Establishing a Road Fund would not only transform the long-term future of our road network. It would give road users the rights they have long deserved and restore trust in motoring taxes.

7. Better for Britain Too

It is widely understood that the performance of our road network feeds through to national productivity, competitiveness and growth. But roads are not unique in this respect. Treating illness through public health services, and ensuring literacy and numeracy through public education both have important impacts on productivity too. Unlike roads, these services do not yield substantial tax revenues which could be used to fund them.

It is fair to ask:

- Is it right to make roads a special case, protecting investment in them?
- If a significant element of motoring taxes is ring-fenced, could this have an adverse impact on other, equally important public services?

A special case?

Road investment doesn't *deserve* special status because spending on roads is 'better' than other spending, or because road users contribute handsomely to government coffers. Rather, road investment *needs* special treatment because without a ring-fenced fund it is particularly at risk in the Budget decision-making process.

It is worth reiterating the reasons why.

- The capital-intensive make-up of the roads budget makes it much harder to defend against short-term fiscal pressures. (It is easier, from almost every standpoint, to cancel or defer uncommitted capital spending than to cut big current spending programmes such as health, welfare or education.)
- The time needed to deliver major road projects extends *far* beyond the electoral cycle and dwarfs the typical lifespan of ministerial appointments. Outcome accountability under the present system is therefore endemically weak.
- The economic cycle seldom meshes harmoniously with the roads planning and funding cycle. When times are hard, politicians understandably

struggle to prioritise roads spending. When the economy starts to pick up, momentum is slow to recover from the previous downturn. Consequently opportunities to ramp up investment can seldom be turned to full advantage: “can’t afford it” turns into “can’t spend it” and before long reverts to “can’t afford it” once again.

Collateral damage?

There is no reason to believe that the generality of public services would be damaged by ring-fencing merely an *element* of motoring taxes. In fact motoring taxes will continue to support a range of other public services, ring-fencing or no ring-fencing. Fuel duty brings in *much* more revenue than will ever be needed to pay for our roads – a massive £26.7 billion in 2013 (DfT, 2014b).

Today there is a strong political consensus that investment in our road network must be boosted and protected. If this is to be achieved, the money to fund the investment will obviously have to be found somewhere. Assuming the political commitment to delivering a better road network is genuine (and we believe it is), then neither the government nor society at large has anything to fear from ring-fencing VED to fund roads. It can make no practical difference to other programmes whether the money for roads comes from VED or from any other form of taxation.

End discrimination now

Here is one final thought.

It is strikingly anomalous that roads have been left at the mercy of government Budget pressures, while other infrastructure sectors like energy, water and telecommunications are well insulated from political risk by virtue of direct user funding.

Roads are no less important than other infrastructure networks. Road investment must be protected from political risk too. The time has come to scrap an outdated public accounting convention which does more harm than good. Entrenched discrimination against roads is illogical and more importantly, harms our national interest.

The time for a new Road Fund has come.

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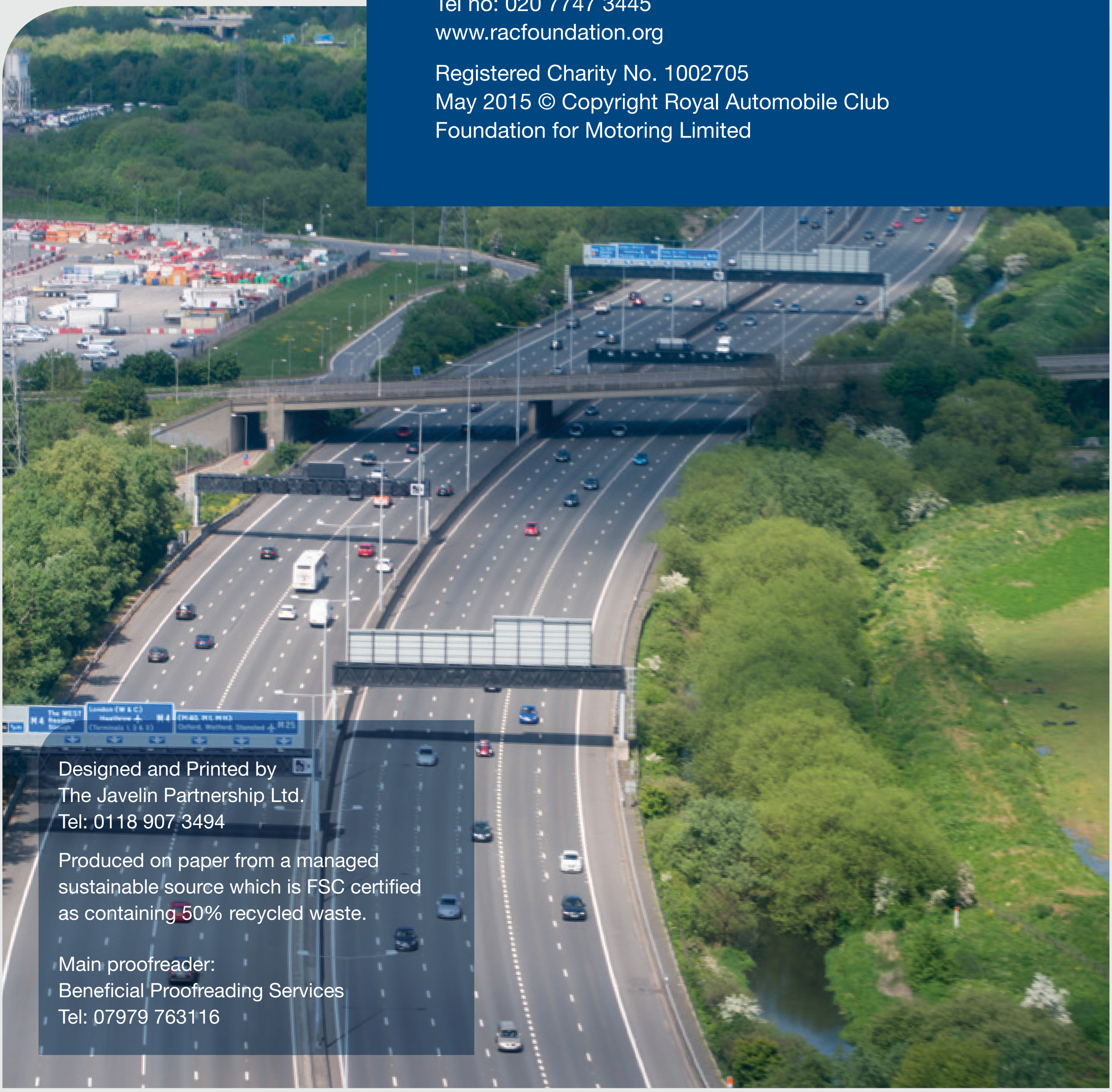

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