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CABINET
ECONOMIC STRATEGY COMMITTEE

PRIVATE FINANCE FOR ROAD CONSTRUCTION

Note by the Chief Secretary to the Treasury

1. The Secretary of State for Transport's paper E(82)24 seeks colleagues' agreement to his inviting tenders to test the feasibility and cost of his preferred scheme for using private capital for the initial construction (and possibly maintenance) costs of a trunk road. I have considerable reservations about this proposal. I would ask colleagues to remit road financing schemes, with the other construction proposals in E(82)22, to officials for further study.

Purpose of alternative financing schemes

2. It is argued that there are a number of worthwhile and popular roads schemes which are being held back for "lack of funds". But, as explained in E(82)22, the purpose of exploring alternative financing methods is in any case not to add to the total money being spent on public projects - that is an entirely separate question - but to inject market disciplines into existing programmes. The purpose of alternative forms of financing should be to make the economy work more efficiently rather than to bolster demand. It is only on this basis that the extra cost to public funds of such financing as compared with gilt-edged borrowing (which is recognised in paragraph 7 of E(82)24) can be worthwhile. The criteria are more fully set out in paragraph 3 of Annex B to E(82)22.

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Present proposal

3. The major difficulty with the Secretary of State's scheme is that the opportunity for a contractor to influence the use or even the cost of his road is very limited. Given the Department of Transport's planning and safety responsibilities, there will be virtually nothing that the contractor can do, which will affect the amount of traffic which used the road, on which his return would largely depend. The uncertainties for him would be:

i) the date by which he can open the road (I agree with the Secretary of State that the prospect of earlier royalties may encourage a minor gain in efficiency, although I think existing contracts could be strengthened to meet the same objective);

ii) the effect of his responsibility for major repairs during the 15-year royalty period (but, again, this is largely covered in conventional contracts); and

iii) growth in the number of vehicles.

4. Thus, there will no gain resulting from bringing entrepreneurial skills to bear. We are simply discussing an alternative way of paying for roads out of public expenditure. And since the growth in the number of vehicles is not a factor over which a contractor has any control, in order to protect his return he will inevitably need to add an extra margin. This will simply increase the cost to the Government.

5. I cannot accept the Secretary of State's argument that deferred payments for construction will allow us to pay when we can 'afford to', as national income grows. First there is not necessarily a direct correlation between traffic growth and national income. On the motorways, for example, traffic growth has been much faster than expected, despite lower economic growth than was predicted in the early 1960s. If the proposed scheme

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had been in operation we would only just have finished paying excessive royalty payments for the mid-1960s motorways. Second, and more important, the nation's resources are used when the road is built, not when deferred payments are made. Postponing payment does not defer the burden which Government-inspired expenditure imposes on the rest of the private sector, through interest rates and taxation.

Alternatives

6. What we ought to look for are schemes which genuinely increase market disciplines, and encourage greater efficiency. They should reduce, or at least be neutral compared with the burdens of conventional public spending, unless the gain in efficiency is demonstrably substantial.

7. It might be worth considering, for example, the effect of letting the private sector recoup construction costs not from Government but from tolls. I have not seen any study showing this to be impractical, and the long lead-in times for roads contracts suggests that legislation need not be an insuperable obstacle.

8. Alternatively, provided that satisfactory arrangements for controlling the flow of spending could be made, we could try to build on the Secretary of State for Transport's scheme by devising a new tendering system for all schemes which was more closely geared to the market's demand for roads.

9. For example road builders could be invited to tender on the basis of their being paid royalties on the traffic flow. If the royalty they required was less than Government's assessment of the overall economic return on the road (plus, if appropriate, some allowance for environmental or other benefits) then the road would in principle be worth building. If it was more then the road would be dropped from the programme. This could provide a genuine market test of the size and composition of the roads programme.

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Conclusion

10. Ideas for the use of private finance for road building need to be much further developed before we embark on a trial run. Otherwise we are in danger of sanctioning schemes which will add to the cost of building roads with no real efficiency gains. There is no virtue in holding down public spending in the short term while building up potentially greater commitments for the future.

L.B.

HM TREASURY
8 March 1982

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