Transport.

P.0676

PRIME MINISTER

Private Finance for Trunk Road Construction
(E(82)24 and 25)

BACKGROUND

In E(82)24 the Secretary of State for Transport asks the Committee to endorse the development of a scheme for private sector financing of trunk roads with a view to inviting, on a trial basis, competitive tenders under the present and the proposed systems. The Chief Secretary, Treasury records his reservations in E(82)25 and recommends that the ideas should be remitted for further study by officials.

2. The Secretary of State for Transport proposes that contractors should bid competitively for a road scheme with their payments based on a royalty per vehicle using the road rather than on progress payments of capital sums as under the present tendering procedure. The contractor would be at risk in that his returns would depend on whether traffic grew faster or slower than expected. On the assumption that the capital expenditure incurred by the private sector did not count as part of the trunk road programme for public expenditure purposes, the public expenditure (on royalty payments) would be spread over a long period and construction companies are said to be interested in the possibility of such an approach which might offer a way of advancing road schemes and taking up slack in the industry.

3. The Secretary of State for Transport recognises that if traffic grew as expected the financing costs would be higher in the long term because the cost of borrowing would be greater than borrowing from the National Loans Fund and the contractor would be looking for a cushion against risk. He argues, however, that the only way to find out whether these costs would be more than offset by benefits is to put the scheme to the test by inviting tenders for one or two roads on the conventional and the proposed basis.

4. The Chief Secretary clearly believes that the advantages of private sector financing on these lines are illusory. The Secretary of State for Transport has acknowledged that this scheme would not bring significant advantages by way of improved efficiency and the Chief Secretary sees it primarily as an alternative way of paying for roads out of public expenditure. He argues there is no virtue in holding down public spending in the short term while building up potentially greater commitments (because of the higher costs of private sector financing) for the future. Although public expenditure as defined would not be increased noticeably in the present Survey period the economic effect would be the same since resources would be used just as if the schemes had been financed directly by public expenditure under present methods. The Chief Secretary may also point out that the present road programme is underspent and so there is scope for further activity within existing programmes.

5. The Chief Secretary further proposes consideration of letting the private sector recoup construction costs not from royalties paid by the Government but from tolls (his paragraph 7) and alternatively trying to devise a new tendering system for all road schemes whereby road priorities were judged against the willingness of road builders to tender on the basis of royalties paid on the traffic flow (his paragraphs 8 and 9).

MAIN ISSUES

<u>The Secretary of State for Transport's scheme</u>

6. It should be common ground that some further work by officials will be necessary before a scheme on the lines proposed by the Secretary of State for Transport could be launched. It will be necessary to prepare a 'prospectus' for the scheme which would set out, for example, the level of royalties on offer and the period over which they would be paid, and the liability of the contractor to payments for maintenance work.

7. The first question is how long this further work should take and what impetus the Committee wish to give to it. The Secretary of State for Transport is clearly looking for action fairly soon. He will accept that the costs of his scheme might not justify the benefits but he will argue that the only way of

finding out whether this is so is to put the scheme to a practical test on the lines he has proposed. In particular it is necessary to find out whether the financial institutions would be willing to support the construction industry in tenders of this sort and, if so, on what terms. This seems reasonable provided it is accepted that if tenders on the proposed 'royalty' basis turn out in practice to offer no advantage over tender on the present basis, then this particular form of private sector financing would not be pursued. The Committee will wish to guard against the risk that expectations of the possibilities for the royalty scheme should be aroused to such an extent that it would be difficult to drop it even if the advantages were not clear.

8. The Committee will also wish to consider whether the Chief Secretary's proposals deserve further consideration and whether they are a potential substitute for the approach proposed by the Secretary of State for Transport or a supplement to it. The Chief Secretary seems to have three possibilities in mind: to strengthen existing contracting procedures in order to secure the possible benefits envisaged in the Secretary of State for Transport's scheme without the disadvantages; to explore further the possibility of letting the private sector recoup construction costs not from royalties paid by the Government but from tolls; and to develop a new tendering system, based on royalties, and applying to all road schemes.

Present Tendering Procedures

9. The Chief Secretary suggests, in paragraph 3 of E(82)25, that some of the benefits envisaged could be gained by strengthening existing contract procedures. If this were practicable it would not necessarily rule out consideration of the Secretary of State for Transport's scheme: the right course would be to compare tenders on the basis of that scheme with tenders on the basis of the existing contract procedures as amended. The Secretary of State for Transport may, however, say that since the standard tendering procedures are agreed with the construction industry they cannot be amended quickly and he might be reluctant to see the first trial of his proposals deferred while revision was taking place. This would not, however, rule out the possibility of revision at a later date.

Tolls

10. In paragraph 7 of E(82)25 the Chief Secretary proposes consideration of the effect of letting the private sector recoup construction costs from tolls. The Secretary of State for Transport will argue that the tolls are at best a longer term possibility which could be introduced only after legislation. The disadvantage of tolls is that traffic would be diverted in practice from the toll road to other roads and this might not be desirable. Insofar as such a scheme is a possibility in the longer term, the Secretary of State for Transport will probably argue that it should be additional to, rather than in replacement of, the scheme he is now proposing.

A New Tendering Scheme

11. The Chief Secretary further proposes, in paragraphs 8 and 9 of E(82)25, consideration of devising a new tendering system applying to all road schemes and based on royalties. The Government would assess the overall economic return required on the road and insofar as the private sector required royalties less than this the road would be in principle worth building and insofar as they required more the road would be dropped from the programme. It is not very clear why such a general scheme would not have the disadvantages which the Chief Secretary sees as applying to the limited scheme proposed by the Secretary of State for Transport; but no doubt he will elaborate in the discussion what he has in mind. The Secretary of State for Transport will probably point out that this would not be a satisfactory basis for determining the size and composition of the road programme because the Government might well be willing to go ahead with a road scheme carrying a modest amount of traffic (on which the private sector return would be based) for environmental reasons (eg a bypass) or to provide a necessary link in a much wider network in which the private sector was not involved. Insofar as the idea is worth exploring further it does not seem to be a reason for delaying a trial of the Secretary of State for Transport's scheme, of which the Chief Secretary's proposal would be a development.

HANDLING

12. After the Secretary of State for Transport and the Chief Secretary, Treasury have spoken to their papers the Committee will wish to hear in particular the

views of the Secretaries of State for the Environment, Industry and Wales.

13. The main questions before the Committee are:

(i) Should Transport and Treasury officials be instructed to work out urgently the details of a scheme to be tried out as proposed by the Secretary of State for Transport?

(ii) Is there scope for improving present contract procedures and could this be done in time for the basis of comparison, in the proposed trial, to be existing contract procedures as amended and the Secretary of State for Transport's scheme?

(iii) Should further work be done on a private sector scheme remunerated by tolls in addition to, rather than instead of, the scheme proposed by the Secretary of State for Transport?

(iv) Should the proposal for a general tendering scheme, as sketched out in paragraphs 8 and 9 of the Chief Secretary's paper, be developed further with a view to building it on to the Secretary of State for Transport's scheme?

CONCLUSIONS

14. You will wish to record conclusions with reference to the four questions listed above.

PG

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