How rapidly can pricing reform be promoted? – A Member State perspective

We have been used to political statements in favour of marginal cost pricing in general and internalisation of externalities in particular. Those principles have been endorsed in:

- The 1992 White Paper on a Common Transport policy
- The 1995 Green Paper on Fair and efficient pricing
- The 1998 White Paper on Fair Payment for Infrastructure Use
- The 2001 Council Resolution on the implementation of sustainablility in transport policy
- The 2001 Gothenburg EU-Summit conclusions and last week I believe we could add
- The 2001 White Paper on *European transport policy for 2010: time to decide*, to the list.

But now I have been asked not to talk about political statements, but implementation. The question is how rapidly can pricing reform be promoted? To try to forecast progress in this area feels a bit scary, but anyway.

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Let me take the pilot-study on estimation of marginal costs in transport and marginal cost pricing that Sweden has conducted together with Finland as a starting point. The study concludes that the developments in Finnish and Swedish rail sectors have made for relatively short implementation paths to marginal cost pricing. It further concludes that the pace with respect to other modes of transport has been slower. The rail can serve as an example of relative success!

When we look at the European arena and European legislation, there are signs of a similar development. Rail is in the lead. A directive covering rail charging has been adopted and is about to be implemented. This should be recognised as a considerable step forward. After lengthy discussions in Council and debates in the European Parliament a directive that endorses the marginal cost principle – although the principle is spelled somewhat differently: The directive states that “costs directly incurred as a result of operating the train servicecaused by individual trains” should be charged the user. The directive also opens for “mark-ups” - given that the market can bear it.

According to the directive a pricing reform in rail should be implemented, at a European scale, no later than March 2003. However, there reasons for caution. The implementation processes is not straight forward in all aspects and at least one MS seems to have a peculiar understanding of the implications of the rail directive…

Let me now leave the first example of progress – or should I say potential progress?

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I have already mentioned the recent Commission White Paper on a European Transport Policy. I haven’t had time to analyse it into all details, but if I should pick one area where I feel that the WP brake new ground I would choose the charging of maritime shipping.

Apart from the July Memorandum from the Commission, this is - as far as I know - the first time the issue is seriously addressed by the Commission or any other international institution. As a Swedish official, of course I am particularly pleased that a reference is made to our Swedish scheme for environmentally differentiated fairway dues. The White Paper states:

In maritime transport, the Commission is looking at the tariffs currently applied in Sweden in this sector, particularly port taxes and taxes to reduce pollutant emissions, in order to se whether this approach might encourage greater account to be taken of external costs elsewhere in the Community. In the light of this examination a Community framework may be proposed...”

In 1997 environmentally differentiated fairway dues were implemented. Today, most ports also apply environmentally differentiated port charges. The schemes have proved to be effective. They have saved us thousands of tonnes of emissions of nitrogen oxides as well as emissions of sulphur. And importantly enough; It has not harmed maritime transport. Rather the opposite. It allows the sector to keep a high profile in sustainability discussions. We are convinced that this or similar approaches would be good for other MS as well. The approach would benefit from being implemented at a European scale.

The scheme is simple and straight forward: Our fairway charges basically consist of a two-part tariff. The first component is related to tonnage and the second to the volume of loaded and unloaded cargo. The former component, the tonnage charge, is differentiated according to environmental performance. The charge ranges from € 0.26 to € 0.53 per gross tonnage depending on the sulphur content in the fuel and existence of equipment to reduce nitrogen oxides. In other words: A dirty vessel pays twice as much as a clean one. Recent marginal cost estimates however suggest that there is scope for increased differentiation.

To summarise, the development concerning the charging of maritime transport appears much more promising today compared to a few month ago. I am interested in learning more about the Commissions timetable. Of course, we would be happy to furnish the Commission and anyone else with detailed information about our fairway charging procedures.

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Let me now turn to roads.

Current national initiatives to introduce km-charging for HGVs are signs of progress. The schemes are likely to aligned charges with marginal costs. But what the newborn White Paper will imply in terms of road charging and pace of implementation of marginal cost pricing in Europe is hard to predict.

On the one hand it is promising that the WP suggests, legislation allowing for marginal cost related charging on the whole national networks, not only motorway and similar roads. We have advocated such a change. In fact, current Eurovignette-directive prevents us from implementing efficient km-charging in Sweden. Km-charges on the part of the network, where we currently are allowed to charge, would lead to deviation of traffic. More than 10 percent of the HGV traffic at our "Eurovignette-network" would deviate to roads of lower quality. The costs to society, in terms of road damage, environmental effects and accidents would increase.

The WP further suggests the possibility of mark-ups on roads to fund rail links. It is put along following lines:

"The framework directive will have to authorise exemptions allowing an element to be added to the amount needed to offset the external costs. This element would be for the financing of alternative, more environmentally friendly, infrastructure. This option would be reserved for infrastructure essential for crossing natural, environmentally fragile/sensitive(?) barriers, and would have to be examined in advance and closely monitored by the Commission."

What is this? A foreseen development in line with the phased approach outlined in the WP on Fair Payment for Infrastructure use? No, it is rather something fundamentally new - A suggestion that deserve an in-depth analysis. Of course, the few days we have had the suggestion in our hands has not allowed us to make any conclusive analysis yet. Neither myself, nor the Swedish government have formed an opinion on the issue. Nevertheless, I would like to raise some questions and share a few thoughts about the suggestion with you:

Let med first conclude that this “exemption to allow an element added” is a tax in the economists sense. I foresee that many ministries of finance also will draw this conclusion. This may have some implications at the institutional level; Council decisions should be taken unanimously rather than by a qualified majority.

Let us forget the formalities for the moment and ask the more interesting question. **Is it a good idea to tax freight transport above the level of relevant externalities?** According to economic theory one would assume: no. Intermediate products such as freight transport should not be taxed. It can be expected to be more distortive and harmful to the economy than other alternatives. Revenues would probably better be raised through indirect consumption taxes like VAT or taxes on inputs or profits.

In the European context the suggestion may also appear politically odd: Is it a good idea to tax trade – tha’s what it is – isn’t it? Should we introduce a sin tax on the very hart of the European idea – the Common market?

I guess that the debate also will question the need for an exemption “allowing an element to be added” on top of marginal costs. The justification for the suggestion is that the add-charge should contribute to the financing of more environmentally friendly infrastructure. In other words, the infrastructure in place is not environmentally friendly. Given the basic marginal cost principle, charges should include marginal, environmental costs as well as marginal congestion costs. And if the problems are severe – one would expect considerable such charges. Those revenues can well be allocated, by a MS, to the investment in other more environmentally friendly infrastructure. It seems that we already have a mechanism for what the Commission want to achieve?

I guess that the advocates of the Commissions suggestion would argue that those revenues are not sufficient. If the environmentally friendly alternative is a rail tunnel it may well be true. The question we then should ask if we have any other, less distortive alternatives, to raise funding. I would like to draw your attention to two alternatives.

1) The WP on Fair Payment for Infrastructure Use suggested a possibility to charge average costs on new infrastructure for a period long enough to reach cost recovery. This is not a theoretically optimal solution, but it has the advantage, compared to the Commission suggestion, that it involves a profitability test of the project and it does not harm transports and the efficiency at other links
2) We have the Trans-European-Network. Isn’t it projects like those that TEN-funding should be provided for? I am fully aware that the amount of TEN funding currently is limited. But in connection to a WP I think that a deeper discussion on TEN and its budget line has a place and should be discussed as an alternative the “exemption to add an element on top of marginal costs”.

Concludingly, I might sound very sceptical about the suggested idea of road “mark-ups”. As I initially said S has no position on the issue. My point in this context is rather to illustrate the complexity of the new issue brought up in this area. My spontaneous fear is that this suggestion may delay rather than promote the implementation of MC-pricing.

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Sometimes I am asked whether I don’t find it tiring to work in a field where so little progress is seen. Of course one would ask for more, but as I think that my presentation has indicated, a lot is happening and we can even identify progress.

From a Swedish perspective this is obvious, we don’t have perfected MC-schemes, but we have a lot of experiences of modulation and differentiation and we have also a great number of cases were such schemes have had substantial effect.

The question was: How rapidly can pricing reform be promoted? My answer is clear. If we apply a pragmatic approach the pace can be rapid. I would like to end by quoting a general conclusion of the FIN/S pilot study.

Our study concludes that the most viable route towards the implementation of marginal cost pricing is via tax and charge differentiation and modulation.

- Experience demonstrates that relatively simple price signals and rough differentiation can trigger considerable adjustments and increase the overall efficiency of the transport system.
- Differentiation requires less knowledge than pure marginal cost pricing. It requires information on relative costs rather than absolute costs.
- As differentiation can be embodied in current charging schemes it is a natural component of a piecemeal approach.
- Differentiation can be combined with given budget constraints.
- Differentiation tends to involve fewer acceptance problems. It is less complicated to explain the rationale of and gain acceptance for charge differentiation than in the case of pure marginal cost pricing.