

***Presentation to OECD/ITF Global Forum of Sustainable Development,  
10-12 November 2008, Guadalajara, Mexico***

***Mind-forg'd manacles:  
The constraints to optimising urban transport policy***

***Dr Rana Roy  
Director of Economics  
Maunsell-AECOM***

## *Introduction*

- A definite thesis – aiming at first best is the best guide to policy even in an inevitably second-best world.
- The background paper develops the underlying theory and why the second best can be a bad guide to policy.
- Here we focus on the positive message – it is possible to overcome the constraints to optimising policy.

## *Structure of the presentation*

- The welfare optimum in a second-best world.
- Optimal policy in urban transport – its three components – pricing, investment, regulation.
- Constraints to optimising policy – economic and financial, politics and civil society, governmental and institutional – and how these can be overcome.

## *The welfare optimum in a second-best world*

- Walrasian equilibrium and the  $P = MC$  rule.
- Not a description of the real world but a heuristic device and a guide to policy.
- Competition policy in contestable markets;  
internalisation of externalities across all sectors;  
tax-and-subsidy to correct significant market failure.

## *Optimal policy in urban transport*

- The double market failure in transport markets.
- Prices can be far above marginal social costs as a result of increasing returns to scale, high fixed costs, low marginal costs – most pronounced in rail/metro.
- Prices can be far below marginal social costs as a result of externalities – most pronounced in urban road use.

## *Optimal pricing (continued)*

- In order to correct the double market failure and the consequent distortion in relative prices, we need:
- A subsidy to cover fixed costs so as to reduce the marginal user price to the marginal social cost of use.
- And a tax to internalise external costs so as to raise the marginal user price to the marginal social cost of use.

## *Optimal pricing (continued)*

- Today: prices are roughly right in rail/metro but far below marginal social cost in road use, esp. passenger cars.
- Hence, large welfare gains from road pricing. Cf. ECMT 2003 (*circa* € 10 billion per year in Britain, France, Germany, up to 90% of which accrue to urban areas).
- Progress to date – in Europe but also US and elsewhere.

## *Optimal investment*

- Invest if  $NPV > 0$  ... at the correct discount rate.
- High discount rates and short evaluation periods: penalising projects with longest streams of benefits and lowest future costs, discounting the future away.
- Progress to date – in particular, in Britain. Cf. Treasury Green Book 2003 and the revaluation of urban rail/metro.

## *Optimal regulation*

- Regulation of vehicle standards (subject to cost-benefit test) – in particular, safety, emissions and fuel efficiency.
- Road traffic management to complement road pricing – already in place for scheduled services (aviation, rail).
- A minimum of regulation of the new pricing system itself: i.e., regulation to enforce the  $P = MC$  rule.

## *The constraints to optimising policy*

- Main economic constraint to optimising pricing – absence of the technology required to do it – i.e., to charge for costs that vary by route, time of day and vehicle type.
- Now that the technology is available, economic benefits of marginal social cost pricing far outweigh the costs.
- Note: road pricing is a financially-positive investment.

## *The constraints to optimising pricing (continued)*

- The supposed political constraint of public opposition – a mind-forg'd manacle.
- The evidence from comprehensive polling (RAC), referenda (Stockholm) and elections (London).
- The experience of cities and countries that have carried it through to completion – the record of public support.

## *The constraints to optimising pricing (continued)*

- A more serious constraint – the division of powers and responsibilities between the various levels of government.
- Local authorities must be equipped to meet set-up costs and to provide public transport alternatives.
- Local action alone cannot optimise pricing. But it can help to trigger the requisite national solution. Cf. London.

## *The constraints to optimising investment*

- The argument that we “cannot afford” worthwhile investments – another mind-forg’d manacle – with disastrous macro-economic consequences.
- The events of 2008 will prompt a revaluation of public investment, a devaluation of certain other “assets”.
- Once again, need to match powers and responsibilities.

## *The constraints to optimising regulation*

- Vehicle standards: the European experience – largely positive – but we need to develop common international standards in a world of free international trade.
- Advanced road traffic management – in progress across the OECD world.
- Regulation of pricing – the need to renegotiate PPPs.

## *Conclusion*

- A positive message to public authorities responsible for urban transport:
- An optimal policy on pricing, investment and regulation will deliver very large gains relative to what obtains today.
- The constraints to optimising policy – insofar as they are not imaginary, mind-forg'd manacles – can be overcome.