To toll or not to toll, that is the question?

David Bailey, professor of international business strategy and economics at Coventry University, questions the need for an M4 toll road

The need to ease congestion on the M4 near Newport has long been recognised as a priority. Business leaders argue that local traffic jams damage growth in the South Wales economy. In fact, plans were announced as early as 2004 for a 14-mile Newport relief road between junctions 23 and 29 of the M4, but escalating costs saw the scheme scrapped in 2009.

But now it seems that the Government is looking at an M4 toll road. I'm wondering why they're bothering. Why come up with a hugely complicated scheme to sell rights to build a road and charge tolls to sovereign wealth funds and infrastructure multinationals when it would be far cheaper for the Government to just borrow the money by issuing bonds at historically rock-bottom rates?

Chancellor George Osborne doesn't want to do this, of course, because like with PFI, he wants to keep this off the Government's balance sheet, so as to keep reported borrowing and debt figures down. But also like early PFI schemes in particular, this often ends up costing a lot more than simple bond financing in the long run and just like any other debt will have to be repaid 'on the never-never' over decades.

Furthermore, the limited experience with road charging in the UK isn't exactly encouraging. The M6 toll was designed to take up to 100,000 vehicles a day but is now running below one-third capacity. The road's owner, Macquarrie Motorway Group (MMG), an Australian firm, has raised toll charges repeatedly for cars from £2 in 2004 to £5.50 today. The road is now one of the most expensive stretches of toll-road in Europe.

Higher toll charges

Not surprisingly, higher toll charges have meant fewer drivers. Recent figures are amongst the lowest in the road's history, with the average daily number of motorists using the M6 toll at just 30,418 in early 2012, in contrast with a peak of 54,700 back in 2006.

Raising prices so much may make sense for MMG, but this isn't the same as maximising wider social benefits, including getting traffic off the M6 and easing congestion. In fact, MMG wants to see more congestion elsewhere so as to encourage drivers on to the M6 toll and hence pay high prices.

Not surprisingly, last year Macquarie has had to write 20% off the value of its M6 toll road investment. It had previously assumed that traffic would grow at 2.24% during the lifetime of the deal. Yet revenues in the year to December 2011 actually fell by 7%. MMG losses ran at £224 million in 2011, with £1 billion owed to banks. That latter debt was stacked up back in 2006 when a £400m payout was made to Macquarie. M6 toll drivers are effectively now paying for it.

MQA itself has stressed long-term challenges for the road, stating that *"the outlook for future economic conditions in the UK remains uncertain. Future traffic, revenue performance and ongoing compliance with debt covenants of the M6 toll will be subject to economic factors outside its control."*

And that £1bn debt pile has to be repaid in three years and will require refinancing. That will be a challenging sell when traffic volumes are dropping and the interest rates Macquarie is paying are going up (back in 2006 it took out a complex series of stepped interest rate swaps and from 2011 the rate rises by 0.25% every six months, peaking at 8.5% in 2025).

But what does seem clear is that the financial problems with the M6 toll don't bode well for private sector investment in roads like the M4, which is something the Government is trying to encourage.