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## **INTERNALISATION OF TRANSPORT EXTERNAL COSTS**

### **Executive Summary**

BUSINESSEUROPE, in this paper, sets out its views on a forthcoming Commission Communication, which will provide a general framework for the calculation and internalisation of external costs in the transport sector and will serve as a reference for future calculations of infrastructure charges.

BUSINESSEUROPE supports more efficient transport and believes that there is a case for charging for the use of infrastructure provided that (1) the level of charging is not higher than the marginal social costs (2) it applies to all transport modes, (3) the charging is part of the financing mechanism for infrastructure and of an integral policy aimed at a competitive European economy.

Concerns that the Commission needs to address are:

- A level playing field for all transport modes is essential when charging for external costs
- It is not always the case that the transport user should bear the burden
- The Commission's methodology should adopt an integrated approach taking into account economic, social and environmental dimensions, with a view to safeguarding the competitiveness of the European economy in line with the objectives of the Lisbon Agenda
- The need to take into account existing charges and taxes in all Member States, which vary widely across the EU-27, whilst also recognising that transport users do already bear most of the costs linked to transport
- The Internalisation of external costs is not a panacea for the side-effects of transport activities. In this context, the Commission should also focus efforts on combining infrastructure charging with other policies
- A thorough impact assessment is needed to see the advantages and disadvantages of any internalisation measures on the economy.

## BACKGROUND

The Internalisation of external costs has been on the European transport policy agenda for many years. This issue has been raised in documents such as the 1995 Green Paper on Fair and Efficient Pricing, the 2001 White Paper on European Transport Policy and its 2006 midterm review, Keep Europe moving.

The Commission's rationale behind this concept is that transport activities give rise to environmental impacts, accidents and congestion, and that the costs of these effects of transport are generally not or only partly borne by the transport users. It is considered that without policy intervention, these so called external costs are not taken into account by the transport users when they make a transport decision. Therefore internalising such external costs would mean making such effects part of the decision-making process of transport users (e.g. what form of transport to use, how, at what time).

When amending Directive 1999/62/EC<sup>1</sup> (Eurovignette Directive) in 2006, the European Parliament sought and received a commitment from the European Commission to present by the summer of 2008 a generally applicable, transparent and comprehensible model for the assessment of all external costs (including those caused by non-road modes) to serve as the basis for future calculations of infrastructure charges.

Internalisation of external costs by market-based instruments (such as pricing or emission trading) is generally regarded as an efficient way to limit the negative side effects of transport. This is the basis for the concept of marginal social cost pricing (MSCP), which involves charging users for the costs that arise from an increment in traffic. These encompass additional wear and tear costs plus marginal external costs linked to noise, air pollution, congestion and others. Most economists agree that pricing according to this rule encourages efficient use of existing infrastructure. However, since marginal costs in general are lower than average costs, they will not cover total costs.

In this context, DG TREN has launched a study to review the best practices in the estimation of external costs and to propose an appropriate methodology, which has resulted in the production of a handbook<sup>2</sup> by CE Delft, a consulting firm.

BUSINESSEUROPE would like, in this paper, to set out its views on the work in progress by the Commission, namely a Communication to be adopted in July 2008, which will provide a general framework of reference for the internalisation of external costs in the transport sector. The foreseen Communication may be accompanied with legislative proposals, notably in relation to a revision of the Eurovignette Directive on the charging of heavy goods vehicles for the use of certain infrastructures and which is expected to allow member states to impose tolls linked to pollution, noise and road congestion on heavy goods vehicles.

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<sup>1</sup> Directive 1999/62 EC on charging heavy duty vehicles for the use of certain Infrastructure.

<sup>2</sup> Handbook on estimation of external cost in the transport sector, Produced within the study Internalisation Measures and Policies for All external Costs of Transport (IMPACT), December 2007.

## **POINTS TO BE CONSIDERED IN ANY METHODOLOGY FOR CALCULATION AND INTERNALISATION OF EXTERNAL COSTS**

The ability to move goods efficiently and rapidly is a key element of the EU's goal for a dynamic economy. The transport sector generates 10% of EU wealth measured by gross domestic product and provides more than ten million jobs<sup>3</sup>.

BUSINESSEUROPE believes therefore that the Commission's methodology should adopt an integrated approach taking into account economic, social and environmental dimensions, with a view to safeguarding the competitiveness of the European economy in line with the objectives of the Lisbon Agenda.

In this context, BUSINESSEUROPE considers that the following elements need to be considered:

### **1) Level playing field**

BUSINESSEUROPE favours equal treatment for all transport modes. This is vital to ensure fair competition and therefore charging for external costs should apply to all modes of transport without prejudice, on equal terms for all modes.

### **2) Other mechanisms of internalisation are already in use - Avoid duplication**

External costs can include congestion, noise, air pollution, climate change, accidents and others. A mark up on road charging per km is not the only and often not the best option to address this issue. The aim should be to minimise costs for society at large. For example, noise and air pollution may be internalised more efficiently by regulations and standards that vehicles have to meet. Climate change may be better addressed with emission trading than taxes. Insurance premiums can provide incentives if there is a direct link to kilometres driven (pay-as-you-drive) and driving behaviour.

In the Netherlands for example a pilot project is under way with cars equipped with 'on board units' that enable insurance companies to monitor the car and the driving behaviour so as to be able to calculate the accident risk individually and charge for insurance correspondingly. Apart from better cost allocation, this approach results in much more prudent driving behaviour.

Transport users do already bear most of the costs linked to transport. Some taxes already paid can be considered as internalisation, e.g. fuel excise duties and insurance premiums. Costs of congestion are borne by the group of road users together through lost time in congestion. It is essential to avoid duplication of charges that already exist at national or EU-level.

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<sup>3</sup> Figures taken from [http://europa.eu/pol/trans/overview\\_en.htm](http://europa.eu/pol/trans/overview_en.htm)

### **3) Large variations exist in external costs depending on various parameters**

As illustrated by the Commission's IMPACT study and associated handbook, external costs in all modes of transport are often difficult to measure and can vary greatly. Not only do the costs depend on the means of transport used but they also depend on a number of other circumstances, which include whether transport is taking place in an urban or non-urban environment, density of the population, congested or free flow conditions, speed and driving behaviour and specific infrastructure conditions.

For example, the cost to society of air pollution varies greatly depending on the number of people that are affected in a specific area, weather conditions, type of vehicle, driving behaviour and so on. For road transport the Commission's study shows that the external costs can fluctuate from € 0.0 to more than €1.00 per km travelled for the same type of vehicle. An average charge would not lead to beneficial, efficient or fair pricing.

### **4) It is not always the case that the transport user should bear the burden**

A serious challenge exists on how to fairly and precisely attribute and charge costs of infrastructure and internalisation to users (or, eventually, others) to obtain the desired effects. Internalisation of external costs should be part of an integrated approach to economic and transport policy, in which investment in infrastructure and pricing for the use of infrastructure and internalisation are important elements that should however be considered in a broader scope, which should take account of the benefits that infrastructure brings to non-users, society and the economy in general.

It should not be forgotten that transport, for which the use of infrastructure is necessary, mostly benefits the economy. Especially in peripheral areas, where transport connections are yet to be developed, it is not efficient to let users pay all infrastructure costs since this would only contribute to under-utilization of capacity. The transport sector creates wealth, is crucial for modern society and is a prerequisite for the successful operation of the EU single market. Therefore, EU policies on competitiveness and transport should not be in contradiction with one another.

Also, it is not always obvious that the user of infrastructure should pay for (the mitigation or compensation of) external costs, for the 'cause' of (increase of) external costs may sometimes not be the use of the infrastructure.

### **5) Use of revenues; connection with financing infrastructure**

BUSINESSEUROPE believes that total revenue raised from infrastructure users should never exceed total infrastructure expenditures, including the necessary and efficient measures to protect the environment. Mark-ups based on external costs are only acceptable if the revenue is part of the financing mechanism for infrastructure and environmental provisions. The revenue generated should not disappear into the state's general budget.

## 6) Impact assessment

Overall, BUSINESSEUROPE understands the need to cope with external effects of transport, but emphasises the complexity and possible negative consequences that the Commission's internalisation methodology could have. The danger of overpricing transport is real, to the detriment of a competitive Europe. Charging for the use of infrastructure related to distance travelled and differentiated for peak and off-peak conditions can be efficient and acceptable, provided that over-charging and unfair competition is avoided. In any case, BUSINESSEUROPE would want to ensure that a thorough impact assessment be carried out to see the advantages and disadvantages of any internalisation measures on the economy.

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