

Regulatory Impact Assessment: Lorry road-user charge

March 2005



HM TREASURY



HM Customs and Excise

Department for
Transport



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INTRODUCTION

ISSUE

1.1 The lorry road-user charge (LRUC) is designed to deliver the Government's manifesto commitment to ensure that all lorries using UK roads contribute on a fair and equal basis towards the costs that they impose. The charge is intended to modernise the taxation of the haulage industry in line with the objectives the Government has set for LRUC.

1.2 The Government recognises that many operators already contribute towards the costs that they impose, through UK vehicle excise duty (VED) and fuel duty, and so has confirmed that offsetting tax reductions would be provided by a reduction in fuel duty for lorries using UK duty-paid fuel.

1.3 A procurement exercise for LRUC is currently underway. Prospective suppliers are being asked to propose and develop specific technological solutions to meet the Government's requirements. It is expected that this exercise will result in contracts being awarded around the end of 2005.

1.4 This report is being issued before the procurement has been concluded, and at a stage when the technological solution and hence the likely costs are still not firmly established, as the procurement process is asking the market to design the solution that would best meet the requirements. It therefore covers what is known so far and explains some of the Government's assumptions about benefits and costs. The Government will consider the costs in detail when assessing the business case for the potential solutions, and will set out further information once contracts have been signed at the end of the procurement process (it is expected that this process will result in contracts being awarded around the end of 2005). A lot of this information is commercially sensitive and it would prejudice the procurement process if this information were to be published before the procurement process was completed.

1.5 In developing LRUC, the Government has worked very closely with representatives of the UK haulage and related industries, and progress has been regularly reported in a series of Progress Reports. A more detailed summary of the progress made so far with LRUC can be found in Chapter 7. A further progress report will be published shortly.

OBJECTIVES

1.6 The objective of LRUC is to ensure that all lorries using UK roads, regardless of nationality, contribute on a fair and equal basis towards the costs that they impose. Decisions on the rate structure have not yet been taken, but the Government intends that the charge should be able to be varied to reflect the costs associated with road use, such as climate change and local air quality.

1.7 The Government is mindful that the new system should work with the industry, not against it, so it will seek to implement LRUC in a way that minimises any administrative burdens for hauliers while also minimising any fraud risks. By working closely with the haulage industry, a user charge can be introduced that meets the needs of the sector and delivers a fairer environment for all hauliers operating in the UK.

RISK ASSESSMENT

Importance of the road haulage sector

1.8 The road haulage sector plays an important role in securing a productive economy, and is responsible for the majority of freight movement within the UK. In 2002, it accounted for over 80 per cent of goods lifted (tonnes), and over 60 per cent of goods moved (tonne kilometres) in Great Britain¹. This dominance stems from road freight's cost-effectiveness and flexibility, particularly over short distances, and its adaptability to changing customer requirements.

1.9 The importance of road haulage has increased following the creation of the single European market, and the resulting growth in trade between member states. The number of foreign-registered lorries travelling to Great Britain increased by over 200 per cent in the decade to 2003². There has also been an increase in the number of trips by UK hauliers to mainland Europe, though the growth rate is not nearly as pronounced as for foreign vehicles entering the UK – and the number of UK trips overseas has declined gradually since peaking in 1999. These trends are illustrated in Figure 1.



1.10 Various factors could help to explain the relative strength of growth of overseas hauliers carrying freight between mainland Europe and the UK. In particular, the volume of goods imports into the UK has been growing faster than exports from the UK. This may favour foreign hauliers, who have better direct access to the originators of these trips.

The current tax regime

1.11 At present, many hauliers contribute to the costs they impose in the UK through VED and UK fuel duty. However, these taxes are payable only in respect of vehicles registered in the UK (for VED) or by hauliers who purchase their fuel within the UK. Accordingly, different amounts of UK tax are paid according to where vehicles are registered, and where fuel is purchased.

1.12 Hauliers driving on UK roads using fuel purchased outside the UK do not contribute to the costs they impose, resulting in significant revenue losses to the UK exchequer.

¹ DfT: Transport Statistics for Great Britain, London, October 2004.

² DfT: Road Goods Vehicles Travelling to Mainland Europe – Quarter 3 2004, London, November 2004.

1.13 Fuel costs account for approximately 20-30 per cent of total vehicle running costs for UK hauliers³, making them very sensitive to fuel price differentials between the UK and continental Europe.

1.14 As a result, some hauliers purchase fuel in other countries, notably Belgium, France, Ireland, Luxembourg, the Netherlands and Spain, for travel within the UK. A typical HGV travelling in the UK will have a fuel tank capacity of at least 1,200 litres, enabling it to travel some 3,000km⁴ without having to re-fuel. With an average trip length of 640km for foreign hauliers in the UK, it is clear that few foreign HGVs will need to refuel within the UK – and hence few will contribute to the costs they impose.

1.15 In 2003 HM Customs and Excise published estimates on revenue losses in Great Britain⁵. These estimates suggest that, in 2002, the UK government lost over £300 million in tax revenue⁶ due to cross-border shopping of diesel by both UK and foreign haulage operators.

Future trends 1.16 The evolution of trade patterns within an enlarged European Union suggests that demand for international road haulage services will continue to increase. An increased level of international sourcing means that goods might be transported over far greater distances than they have been before. Firms have sought to make use of cheaper manufacturing locations, have centralised production centres to achieve economies of scale, and have increased the take-up of ‘just in time’ production techniques (requiring smaller, but more frequent delivery of goods).

1.17 The result is that the UK is likely to see more extensive use of the public road network, and so an increase in the costs imposed, by both foreign and domestic lorries. At the same time, if more hauliers are operating across international borders, there will be increasing opportunity for some hauliers to avoid contributing to the costs they impose by purchasing their fuel outside the UK.

EUROPEAN CONTEXT

1.18 Many other European countries operate lorry charging schemes, in a variety of different forms. Some member states, for example Belgium, Sweden and Netherlands, operate time-based charges (or ‘vignettes’) for lorries. Meanwhile, Germany, Austria and Switzerland have each successfully introduced distance-based charges across large portions of their road network in recent years, while others (such as France, Italy and Spain) levy tolls on individual motorways for both lorries and other vehicles.

1.19 Two pieces of EU legislation have a bearing on lorry road-charging schemes within the EU:

Interoperability directive

1.20 The objective of the ‘Interoperability’ Directive is to make electronic road charging systems in the EU interoperable, so that eventually it may be possible to have one contract for the means of payment and one on-board unit per vehicle and it may be possible to drive across Europe and receive one statement or invoice for all the charges

³ Source: Freight Transport Association.

⁴ DfT: Survey of Foreign Vehicle Activity in 2003, London, November 2003. This assumes a fuel efficiency of 2.5km per litre.

⁵ HM Customs and Excise: Measuring and tackling indirect tax losses December 2003.

⁶ This figure excludes cross-border shopping in Ireland.

incurred on the different systems used. This is known as the European Electronic Toll Service (EETS).

1.21 Although the Directive entered into force in May 2004, in practical terms its effect will not be felt until various decisions have been taken. Stage 1 is to define the service, which is scheduled for completion by 1 July 2006. Stage 2 is to offer the service to all HGVs over 3.5 tonnes and long distance coaches 3 years later (i.e. planned for mid-2009). Stage 3 is to offer it to all vehicles 5 years later (i.e. planned for mid-2011).

Eurovignette directive

1.22 The 'Eurovignette Directive' sets a common framework for HGV tolls and user charges across the EU. The Directive also sets a framework (including minimum rates) for VED and similar taxes in other Member States. The part of the Directive that concerns tolls is currently subject to amendment following a European Commission proposal in 2003.

HM REVENUE AND CUSTOMS

1.23 Subject to approval of legislation currently before Parliament, HM Customs and Excise and the Inland Revenue are merging to create a single new organisation called HM Revenue and Customs (HMRC). The merger will not result in any significant change to the current powers of Customs or the Revenue. A draft advice note⁷ has been produced about the legal powers of HMRC, the approach HMRC officers will adopt in their dealings with taxpayers and claimants, and the rights of some of the types of people they deal with. For consistency, all relevant references in this RIA are to HMRC.

⁷ Draft HM Revenue and Customs HMRC powers and your rights January 2005

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OPTIONS

2.1 This Chapter describes the main options that the Government has considered in developing its plans for lorry road-user charging.

OPTION A: DO NOTHING

2.2 The Government announcement in the Pre-Budget Report 2000 (see Chapter 7) recognised that there was a need to modernise the taxation of the haulage industry. Doing nothing at all would maintain the existing position, and would fail to tackle the risks identified in Chapter 1. It would not achieve any of the Government's stated objectives and would fail to provide a fairer system where all hauliers contribute on a fair and equal basis to the costs they impose.

OPTION B: INTRODUCE A LORRY ROAD-USER CHARGE

2.3 LRUC would be a new charge that would be levied on all lorries, regardless of nationality, using UK roads. The Government recognises that many operators already contribute towards the costs that they impose, through UK VED and fuel duty, and so has confirmed that off-setting tax reductions would be provided by a reduction in fuel duty for lorries using UK duty-paid fuel (see Box 2.1). The Government has considered a variety of ways in which LRUC could be implemented, and these are discussed in the sub-options below.

TIME-BASED CHARGE

2.4 A time-based charge would consist of a pre-pay scheme where a time-based certificate would be issued and placed on the vehicle's windscreen. It might be varied according to the weight and axle structure of the lorry, similar to the way in which VED is structured. The charge would depend on the time a vehicle spent in the UK, and could potentially be administered alongside reduced levels of VED or a fuel duty repayment scheme.

DISTANCE-BASED CHARGE

2.5 A distance-based charge requires some means of measuring the distance travelled by lorries on UK roads and charging operators regardless of their country of origin. There are two ways in which this could be implemented – a manual scheme and an automated scheme. Either scheme would require the use of some form of distance-measuring equipment fitted to chargeable vehicles, even if it is just the tachograph or odometer. The charge rate per kilometre could be varied according to the type of vehicle, to enable the charge to better reflect the environmental impact, road damage and other costs imposed by lorry traffic. Depending on the type of scheme adopted, the charge could also be varied in relation to time of day and type of road.

Manual scheme

2.6 A 'manually operated' scheme could involve recording of vehicle mileage at regular intervals. For UK hauliers, this could perhaps be collected as part of the annual MOT test. Tachograph readings would need to be recorded manually each time a vehicle entered or left the UK, to ensure that only distance travelled within the UK was

subject to LRUC. A similar system could operate for foreign hauliers, with tachograph readings again taken at each entry to or exit from the UK. Random inspections, backed by appropriate penalties, would be needed to help reduce the risk of fraudulent mileage declarations.

Automated scheme

2.7 Under this option, lorry operators would register for LRUC and have an on-board unit fitted in each lorry, which would measure automatically the distance travelled. The charge would be calculated centrally on the basis of information transmitted from the on-board unit. Lorry operators would receive a regular statement of the amount of LRUC accrued, and of their entitlement to rebates under the accompanying fuel duty repayment scheme.

Box 2.1: Offsetting tax cuts

The Government recognises that many hauliers operating in the UK already contribute towards the costs they impose, through UK vehicle excise duty and fuel duty, and has announced that there will be offsetting tax reductions for lorry operators when LRUC is introduced. The Government has decided that the best way to offset the charge is through a reduction in UK fuel duty, given that current levels of VED are not sufficiently high to enable a typical vehicle's likely LRUC charge to be fully offset.

Two methods of delivering the tax cut on fuel used in lorries were identified:

- use of new marked fuels: this would involve new chemically-marked fuels being produced by refineries that would only be sold to haulage operators for use in chargeable vehicles. Duty would be charged at a lower rate than unmarked fuel.
- a repayment scheme: hauliers would continue to buy normal road diesel at full price, but would be able to reclaim a repayment in respect of every litre of UK duty-paid fuel used in vehicles that are liable to LRUC. The repayment would normally be expected to be netted-off against the LRUC in a single administrative process.

The Government undertook consultation with the oil and haulage industries, as well as its own research on these options.

Given the concerns of the haulage and oils industries the Government decided to develop a repayment scheme for delivering the fuel duty reductions. The main reasons for this are that a marked fuel would require costly infrastructure, which would also cause environmental costs directly and through the need for additional deliveries. There would also be questions about the national availability of a marked fuel for haulage operators, and additional costs would be incurred through the need to provide for marked variants of alternative fuels as well as diesel. Although a repayment scheme would require hauliers to keep records of their fuel usage, this could be achieved through automated electronic systems that would allow common administration with LRUC – resulting in economies of scale, smaller overall transfers of money and crosschecking of data to make assurance and enforcement more effective. A repayment scheme would have to be accompanied by adequate fraud mitigation measures to ensure that the scheme as a whole meets its objectives of fairness.

OTHER OPTIONS CONSIDERED

2.8 The Government has considered a number of alternative options, but dismissed them at various stages in the development of its plans for LRUC. Examples are:

- **Self-regulation** This would rely on the industry adopting different working practices to achieve the Government’s objectives. However the key issue here is one of fair contribution to costs. In the UK this is achieved through taxation measures. Clearly self-regulation alone could do nothing to address the structure of the tax system. It is the Government’s view that self-regulation alone is unworkable in these circumstances. Modernisation of a taxation system cannot be achieved by relying on UK and foreign hauliers to change their behaviour.
- **Cutting fuel duty to EU average levels** Some commentators have argued that fuel duty could be reduced for hauliers through the use of either a new marked fuel or a fuel duty rebate for chargeable vehicles, or that fuel duty could be reduced on a national level. Reductions in fuel duty would, by themselves, reduce the cost of using UK roads, leading to increased traffic levels. This would add to environmental and congestion costs, especially if fuel duty were to be reduced on a national level. All decisions on fuel duty are taken by the Chancellor of the Exchequer on a Budget-by-Budget basis, taking into account all social, economic and environmental factors. Nor would reducing fuel duty meet the Government’s objectives for LRUC, as it would still fail to ensure that all lorries using UK roads contribute towards the costs that they impose.
- **Tax foreign hauliers on entry to, or exit from, the UK or require all hauliers to leave the UK with a full, or almost full, tank of fuel.** Although in principle these options could ensure that overseas hauliers contribute to the costs they impose in the UK, there are substantial practical obstacles. A tax levied purely on foreign hauliers would clearly discriminate on grounds of nationality, and so would not be permissible under EU law. Any requirement to purchase a certain good (in this case, fuel) is likely to be regarded as imposing restrictions on imports and exports, which would be incompatible with EU Treaty obligations. If the enforcement necessary were to delay departing vehicles, this could also create a practical obstacle to the free movement of goods. Therefore it is the Government’s view that imposing these sorts of obligations on hauliers on entry to, or exit from, the UK is not a feasible option.

3

COSTS AND BENEFITS

OPTION A: DO NOTHING

3.1 There are no direct costs or benefits of doing nothing. But it would do nothing to address the risks identified in Chapter 1. It would mean that those hauliers who buy their fuel in the UK would continue to be at a significant disadvantage compared to those who cross-border shop. Furthermore it would allow hauliers driving on UK roads using fuel purchased outside the UK to continue not to contribute to the costs that they impose, resulting in significant losses to the UK exchequer.

OPTION B: INTRODUCE A LORRY ROAD-USER CHARGE

3.2 Such a scheme could be implemented in various different ways, as described in Chapter 2. Decisions on how to implement such a charge would have an impact on benefits and costs. It is only possible to provide a partial assessment at this stage, as the costs and benefits of LRUC will depend materially on the technical solutions emerging from the procurement process, and on decisions yet to be taken about the level and structure of the LRUC charge rates. This section sets out the business sectors that would be affected by LRUC and the broad areas in which benefits and costs could arise; it then goes on to consider how each of the three variants might compare in terms of those benefits and costs.

Business sectors affected

3.3 At this stage, before any rate structure has been established, it is not possible to precisely determine all of those businesses that will be affected. Nor have final decisions been taken about the categories of exemption that may apply to LRUC and this will clearly affect the actual number of vehicles included within the scope of LRUC.

3.4 However, it is clear that the principal sector affected by LRUC will be the haulage industry. The Government estimates that approximately 450,000 UK HGVs, operated by 100,000 UK licensed HGV operators might fall within the scope of the charge. Vehicle and Operator Service Agency (VOSA) statistics suggest that 87% of these operators have 5 or fewer vehicles specified on their operator's licence, 12% have between 6-50 vehicles, just 1% having 50 or more vehicles.

3.5 LRUC will also have an indirect impact on the following sectors:

- hire/leasing companies in lorry market;
- lorry manufacturers;
- fuel companies;
- port operators;
- hauliers' customers;
- consumers/individuals;
- local and central government; and
- other users, such as recovery firms.

Benefits

3.6 Depending on how LRUC is implemented, it could provide some or all of the following general benefits:

- a fairer basis of charging that would ensure that all hauliers would pay the charge on the same basis – regardless of nationality;
- increased government revenue from hauliers who are not currently contributing through UK fuel duty;
- scope to relate the tax paid more closely to the costs of lorry use, for example by strengthening incentives to operate vehicles that cause less pollution and road damage. A suitably-designed LRUC scheme could also incorporate variation in the charge to reflect that the costs of lorry use may vary depending on the type of road (as motorways are more suited to lorry use) and/or time of day (as the environmental and other costs of lorry use are lower at times when traffic is flowing freely);
- the potential for spill-over benefits from the infrastructure or technologies used to deliver LRUC. For example, an LRUC scheme that involved satellite positioning technology could enable more widespread usage of value-added services, such as satellite navigation or fleet monitoring. These could help the haulage industry to improve its productivity, and to manage its operations in a more fuel-efficient, and hence less polluting, manner; and
- the potential for the development of LRUC to provide experience that could facilitate the introduction of any national road pricing scheme for all vehicles, should future governments decide to follow that route (see Box 3.1).

Box 3.1: National road pricing

The findings of the Road Pricing Feasibility Study, commissioned by the Department for Transport, were published in July 2004. It considered how and when it might be possible to deliver a national road pricing scheme in which all vehicles would pay a distance-related charge that could be varied in different places and at different times to help tackle the problem of growing congestion.

Such a scheme would depend upon accurate positioning technology that could determine where, when and how far a vehicle had travelled. Although such a scheme might have some synergies with LRUC, there will be important differences including that LRUC will apply to a much smaller population of vehicles, and that hauliers already use technology such as tachographs and, in many cases, sophisticated on-board telematics and fuel monitoring systems. Accordingly, the systems that are currently being procured to deliver LRUC are the solutions that are needed for lorries. The primary purpose of national road pricing would be to change behaviour in order to tackle congestion, and so such a scheme would differ substantially from LRUC, where the primary purpose is to establish a fair competitive base for the haulage industry.

The differences in aim, scale and technology mean that LRUC is not a trial run for national road pricing. However, LRUC will anticipate some features of any possible national charging scheme and it is expected to provide important insights into the procurement, technological, operational and other issues that would arise. The successful implementation of LRUC could also increase confidence in the viability and deliverability of a national road pricing scheme, which would be beneficial should a future government decide to introduce such a scheme.

Costs

3.7 The following generic costs have been identified in relation to any LRUC scheme:

- costs of setting up, running and enforcing the scheme. These could include:
 - costs of any equipment needed for the charge and fuel repayment scheme;
 - administration costs for chargepayers;
 - administration costs for Government; and
- costs of any revenue losses through fraud.

TIME-BASED CHARGE**Benefits**

3.8 A time-based charge would not correlate closely with the costs imposed by lorries using UK roads, because these costs depend more on distance travelled rather than time spent within the UK.

3.9 This scheme would be heavily constrained by EU law, which places a ceiling on the level of any time-based charge. The low level of a potential charge would mean that any offsetting reduction in fuel duty or VED would be minimal. Hence there would be a minimal levelling of the playing field between those purchasing their fuel in the UK and those purchasing their fuel abroad, and there would also be little, if any, effect on the

level of cross-border fuel purchases. This would not achieve the principal policy objective for LRUC, and would not deliver the Government's manifesto commitment.

3.10 In principle there would be scope to vary a time-based charge according to the emissions class and other characteristics of the vehicle, although it would not be possible to vary the charge by road type or area. The maximum charge rate would leave very little scope to vary the charge in a way that would affect behaviour.

3.11 This scheme would not involve the installation of on-board equipment in lorries, and so there is no scope for value-added services to be applied alongside. However, there could be scope for such a system to support Government e-business objectives, for example by encouraging the use of e-mail and the internet to apply and pay for a time-based certificate.

Costs

3.12 A time-based charge could be introduced relatively quickly. There would be minimal involvement of new technology and the scheme could be compatible with existing systems such as the Driver and Vehicle Licensing Agency (DVLA) database. It would be a simple and easy system to understand and could also be relatively cheap to implement.

3.13 However, the system would be administratively cumbersome, and would be very difficult to assure and enforce – enforcement would have to be undertaken manually from visual checks of the windscreens. Because the points of entry into the UK are relatively few in number there may be logistical problems in operating a ticket-based system, although some of these could be mitigated, for example by making use of pre-payment mechanisms.

Conclusion

3.14 A time-based scheme could be implemented relatively quickly and at low cost, but the benefits of such an approach would be very limited. The responses to the consultation document published in November 2001 (see Chapter 7 for more information) showed that over 80% of respondents believed that a distance-based charge would offer more potential than a time-based charge to ensure that lorry operators contribute fairly and efficiently towards the costs that they impose in the UK.

DISTANCE-BASED CHARGE

Benefits

3.15 A distance-based charge could be levied at a higher level than a time-based charge, given current EU law, enabling sufficient revenues to be raised to allow a more substantial offsetting tax reduction, resulting in repatriation of fuel purchases to the UK. Although no decision on the level of a UK charge has been taken, a distance-based charge would be more effective in ensuring that all hauliers contribute towards the costs that they impose in the UK.

3.16 A distance-based charge would correlate more closely to the social and environmental costs that lorries impose as in many cases these costs are related closely to the distance that a lorry travels. All lorry users, including those who currently purchase fuel abroad, would pay the same based on distance travelled.

3.17 A distance-based charge would encourage more efficient journey patterns. The charge rates could potentially be varied according to other factors, for example:

- to encourage use of less damaging lorries by varying the charge according to lorry weight and number of axles; and
- to improve local air quality by varying the charge according to vehicle emission standards.

3.18 Depending on the rate structure in place, therefore, LRUC could encourage use of less polluting vehicles, and also encourage more efficient journey patterns and discourage empty running. The potential also exists to address further environmental costs.

3.19 Further benefits that could arise from an automated distance-based scheme, as opposed to a manually-administered one, are considered separately in the discussion of that option.

Costs

3.20 The costs of a distance-based scheme are discussed below under the two main options.

MANUAL SCHEME

Benefits

3.21 Although the general benefit discussed above would be derived, a manual scheme would treat foreign hauliers in a fundamentally different way from UK hauliers by demanding payment on leaving the country. There would need to be a significant presence at UK entry and exit points ‘targeting’ non-UK hauliers, which is contrary to EU legislation. The Irish Land Border poses specific problems as there is no routine Customs presence in place.

3.22 Although a manual scheme could be structured to provide some differentiation within the rate structure, for example by reference to weight or emissions standards, it could not cope with journey-related differentials, such as detecting the presence of a trailer, which might be necessary if the Government decided to charge a higher rate to avoid creating an undue incentive to move heavier loads in trailers attached to lighter vehicles. Neither would it be possible to differentiate by type of road or time of day to reflect the variation in environmental and other costs according to these factors.

3.23 As with a time-based charge, the absence of on-board equipment within vehicles means there is no opportunity for the wider application of satellite positioning or other technologies. However, there would be scope for a manual distance-based charge to support Government e-business objectives, for example e-mail and internet transmission of information.

Costs

3.24 Setting up a manual distance-based scheme would involve significant set-up costs, particularly to establish the back-office systems and infrastructure that would be needed to collect and process data from hauliers. Although a manual scheme would not require its own on-board equipment, as it could rely on tachographs to measure distance travelled, hauliers and drivers would be responsible for recording the

tachograph readings on certain occasions, and for transmitting that information to the Government. Tachograph readings would be needed:

- once a year at the annual MOT test for UK-registered vehicles;
- every time the charge rate for LRUC was changed;
- every time a vehicle changed ownership, a reading would need to be certified by both buyer and seller; and
- every time a vehicle entered or left the UK (for journeys to or from continental Europe, and for journeys between the UK and Republic of Ireland).

3.25 As well as imposing a substantial administrative cost on hauliers and the Government, many of the declarations would need to be made by the driver of the vehicle – leaving him or her personally liable to prosecution in the event of any inadvertent error or accidental failure to take a reading at any particular ‘trigger point’. There would be particular costs associated with administering the scheme at the Irish Land Border, where there are over 300 crossing points and, in some cases, several crossing points on a single stretch of road.

3.26 A manual scheme would be highly vulnerable to fraud, leaving legitimate hauliers at a competitive disadvantage compared with the less scrupulous minority. The greatest vulnerability would be through misrecording mileages when entering or leaving the UK, where it would not be practicable to monitor compliance for more than a small minority of vehicles entering or leaving the country. So arguably it would be foreign hauliers, and their UK-based counterparts who enter and leave the UK on a regular basis, who would have the greatest opportunity to avoid paying their fair share of tax. Moreover, examination of commercial records of overseas taxpayers, which could be necessary as part of the process of enforcement and prosecution, could also prove difficult. Relying on tachograph readings presents a further risk of fraud. Although the introduction of digital tachographs should help to reduce that risk, basing LRUC on tachograph readings would increase the incentive for tachograph fraud in the future.

3.27 The fuel duty repayment scheme for a manually-administered LRUC could work in one of two ways. First, hauliers could be required to retain a record every time a vehicle was fuelled with UK duty-paid fuel. Those records would need to be submitted to the government at intervals to demonstrate eligibility for the offsetting fuel repayment. This would entail the haulage industry keeping millions of records, which would then need to be processed by the government. A repayment scheme of this nature would also be vulnerable to substantial abuse and fraud.

3.28 Alternatively, entitlement to the fuel repayment could be based on benchmark fuel efficiencies for different types of vehicle, rather than actual fuel purchased. However, any haulier that operated both in the UK and overseas would have access to non-UK fuel, requiring a fuel-purchase declaration to ensure that the rebate applied only to fuel purchased in the UK. In reality this would amount to the first option, described in the previous paragraph.

3.29 Annual billing could also present adverse cash flow issues for hauliers.

Conclusion

3.30 A manual scheme might be cheaper than an automated one, but it would impose a substantial administrative burden on hauliers, and on the Government. It would put a good deal of personal liability on drivers and would be very prone to fraud. There are specific difficulties in relation to the Irish Land Border. Although a manual scheme would provide some of the benefits of a distance-based charge, there would be no scope to vary the charge by time of day or type of road to reflect the fact that environmental, road damage and other costs differ according to these factors.

AUTOMATED SCHEME

Benefits

3.31 Any charge calculated using an automated scheme could be varied by reference to a wider range of charging factors and more easily updated than a manual scheme, given the likely technologies. The capability to vary the charge more accurately to reflect the costs associated with road use would meet the Government's objective of ensuring that all lorries using UK roads contribute on a fair and equal basis towards the costs that they impose.

3.32 In addition to the general potential to differentiate between different types of lorries, journey-related differentials, such as the presence of a drawbar trailer, could also be taken into account.

3.33 An automated scheme could also enable the charge rate to be varied according to other factors that are related to the costs imposed by lorry usage, without adding to the administrative burden for hauliers or the Government. In particular, the charge could be varied depending on:

- **Type of road** The costs associated with lorry usage are typically lower on motorways, which are designed specifically to cope with high volumes of freight traffic, and so there may be a case for charging a lower rate of LRUC on those roads. The absence of roundabouts, traffic lights and other obstacles to the free flow of traffic mean that lorries can more easily maintain a constant speed, so reducing the environmental impact. In addition, road damage costs, accident rates and the impact of noise pollution are typically lower on motorways. Moreover, a lower charge rate on motorways could offset any perverse incentive to divert onto non-motorway routes where that would result in a shorter total distance travelled.
- **Time of day** Although time-based charging to address congestion would be most effective if applied to all vehicles, rather than just the lorry population, the other costs imposed by lorry usage may also vary according to the time of day a journey is made. For example, the environmental impact of lorry traffic may be lowest on motorways at night, when traffic is most likely to be flowing freely.

3.34 There are benefits for end users particularly in the form of additional services that it might be feasible to offer via new technology – fleet information, improved service in event of a break down, accident or theft. An automated approach is also in keeping with Government e-business objectives.

3.35 Automation will help to keep compliance costs to a minimum. For example, change of details and registration should be possible on-line, which should reduce

compliance costs and provide a useful facility for hauliers to check their accounts at their convenience. An automated scheme also represents the best opportunity to be interoperable with other countries' tolling systems (see paragraph 1.20).

Lessons for national road pricing **3.36** LRUC is a new system for modernising the taxation of the haulage industry, and it will involve a much smaller population of vehicles than any possible national road pricing scheme would. Hauliers already use technology such as tachographs and, in many cases, sophisticated on-board telematics and fuel monitoring systems. The systems which are currently being procured to deliver LRUC are the solutions that are needed for lorries, and LRUC is therefore not a trial run for road pricing.

3.37 Nonetheless, the development of LRUC needs to recognise that a national road pricing scheme may be technically feasible in ten to fifteen years' time. If national road pricing is developed during the lifetime of the LRUC contracts, LRUC will adapt to be consistent with it. The Government is therefore including standard contractual flexibilities for any changes to LRUC which would be required to achieve this.

3.38 LRUC will therefore be able to complement any future national road pricing scheme for other vehicles and is expected to provide important insights into the procurement, technological, operational and other issues that would arise.

Costs

3.39 Although the costs of setting up an automated scheme might be greater than for a manual system, the ongoing administrative costs for hauliers will be substantially lower. The LRUC procurement process is asking the market to design the solution that would best meet the Government's requirements. This process has not yet been concluded, and the technological solution is not known. It is therefore not possible, at this stage, to set out the detailed costs for LRUC. The set-up costs for LRUC will include:

- the costs of establishing back-office systems and infrastructure;
- the costs of producing the on-board equipment (OBE). This will depend upon the technical solution proposed by the preferred bidders – which will become clear later in the procurement process;
- costs for fitting of OBE, including opportunity costs while vehicles are off the road being fitted. These costs will depend upon the complexity of the fitting process, and the extent to which it can be integrated into routine maintenance schedules. These would cease to be an issue once new vehicles are routinely fitted with OBE; and
- costs of training drivers to use OBE.

The Government will consider the costs in detail when assessing the business case for the potential solutions, and will set out further information once contracts have been signed at the end of the procurement process (it is expected that this process will result in contracts being awarded around the end of 2005). A lot of this information is commercially sensitive and it would prejudice the procurement process if this information were to be published before the procurement process was completed.

3.40 The procurement process will be seeking a technical solution that is secure and resilient to fraud, including any potential frauds associated with the use of new technologies or with the fuel duty repayment scheme. The general level of risk associated with an automated system is expected to be lower than the risk posed by

manual schemes. An automated charge would seek to build on data already held, for example by DVLA and VOSA, to reduce duplication of data collection.

3.41 There are delivery risks associated with any scheme that brings together different technological components in a novel way, even when those individual components are widely used elsewhere. Recognising that this is likely to be the case for an automated distance-based charge, the Government has built in time and resources for thorough testing and piloting of the potential solution. The programme has also met the Office of Government Commerce's rigorous Gateway reviews with the next scheduled review being Gateway 3 in late 2005. Given the scale and complexity of the programme, additional interim Gateway reviews were suggested by the Minister and the LRUC team, and a Gateway 2A was carried out in December 2004.

EQUITY AND FAIRNESS

3.42 The main aim of LRUC is to ensure that all lorries using UK roads, regardless of nationality, contribute on a fair and equal basis towards the costs that they impose.

CONCLUSION

3.43 The Government has concluded that an automated distance-based scheme strikes the best balance between delivering the objectives it has set for LRUC, and the need to minimise the administrative costs – particularly for the haulage industry. It is this option for which contractors have been asked to tender. The Government's view is that the market should decide the optimum solution so it has not specified what the technical solution for LRUC would be. The Government will carefully evaluate all approaches offered by the market that will deliver the stated objectives, have robust delivery plans and good management of risks, high levels of assurance and acceptable compliance.

4

ASSESSMENTS

SMALL FIRMS' IMPACT TEST

4.1 The Government recognises that it is important to consider the potential impact of LRUC on small businesses. The detailed impact on these firms will become clearer as the procurement process continues. The Government will continue to take careful account of the interests of smaller hauliers as it develops more detailed plans for the implementation of the LRUC, through the Road Haulage Forum sub-group, and through discussions with the Small Business Service and small business representative bodies.

COMPETITION ASSESSMENT

4.2 The road haulage industry is a highly fragmented one, consisting of a wide range of companies of different sizes, operating in many different sectors. It can be broadly divided into the following markets:

- **Contract Distribution** This is where third party logistics providers offer a supply-chain management service to their customers, of which road haulage is one activity. This sector is dominated by large road haulage and logistics firms who have the ability to make use of advanced IT systems, and invest in the necessary equipment and warehousing to provide these value-added services. Contracts tend to be medium to long term in duration (1 to 5 years).
- **Shared User Distribution** This market refers to road hauliers and logistics companies that consolidate and distribute freight from a number of different customers. This type of distribution is characterised as the 'spot' market and includes ad hoc and short-term road haulage services. These services are offered by both large and small locally-based road haulage companies, but smaller businesses make up a significant proportion of the activities within this market.
- **Own Account** This relates to companies who only carry goods in the course of their own trade and business. Road haulage is generally not the main competency of the company that carries out Own Account distribution. The company (manufacturer or retailer) will accommodate the transportation of its products using its own fleet of lorries.
- **Parcel/ Express Delivery** Operators who are involved in the delivery of time sensitive items of low weight and high value, on a national or international basis.
- **Removals** This sector handles the removal of property for commercial and domestic customers.

4.3 The Government is currently assessing each of these markets to assess possible impacts the LRUC could have on them. Initial findings on the road haulage industry as a whole suggests that the industry is extremely competitive. Firms engaging in road haulage activities have relatively weak price setting power, with smaller firms charging what the market will bear and where larger operators, who may have some ability to negotiate prices, are under increased pressure from shippers to negotiate lower

contract prices. Profit margins are low, with the industry-wide average in the range of 2-3%⁸. The industry is characterised by low barriers to entry, which consequently ensures competition from new entrants and reduces the dominance even of the large operators. The Government will work with the haulage industry to identify any potential unintended consequences that LRUC may have on competition within the industry.

4.4 The Government has confirmed that offsetting tax reductions would be provided by a reduction in fuel duty for lorries using UK duty-paid fuel, acknowledging the fact that these vehicles are already contributing to the costs that they impose. However, the effect on individual firms is unknown at present. This analysis largely depends upon the rate structure that is chosen - a decision that has yet to be taken - as well as the type of lorries operated by each firm. Compliance costs may differ with size of firm, but it is too early to analyse this, as this is solution dependent. Further work will be carried out before the relevant decisions are taken.

4.5 Although compliance costs may vary between differently sized firms, the Government does not expect that an automated distance-based LRUC will lead to higher set-up or ongoing costs for new entrants compared to established firms. All chargeable vehicles manufactured before or after the charge is introduced will be subject to the same requirements. In the medium term (before lorries are routinely fitted with LRUC equipment when they are manufactured) it may be that set-up costs are slightly lower for new entrants into the market, as LRUC equipment could potentially be fitted into vehicles before they are purchased. New firms entering the market should not be affected any differently from those already established, and therefore this option will not act as a significant barrier to entry.

4.6 The increased use of transport telematics within the industry suggests that the sector is innovative, although it is not characterised by rapid technological change. Rather than restricting innovation, the Government is seeking a solution that complements the trend towards using more advanced technology, and at present is actively dealing with interoperability issues in Europe.

4.7 LRUC is designed to ensure that all lorries using UK roads contribute on a fair and equal basis towards the costs that they impose. Those lorries driving in the UK using non-UK purchased fuel are currently able to gain a competitive advantage, through lower costs, compared to those using UK purchased fuel. Ensuring that all lorries contribute on a fair and equal basis will level the playing field, and ensure that lorries compete on an equal basis, enhancing competition.

REGIONAL ASSESSMENT

4.8 Although the Government has confirmed that offsetting tax reductions would be provided by a reduction in fuel duty for lorries using UK duty-paid fuel, different operators will be affected in different ways, depending on the size and type of their HGV fleet, and on their operating practices. These impacts could differ across different parts the UK, with differing consequences for regional economies. A full regional impact assessment will be carried out, but obviously the effects will depend on the rates that are set. Work is underway to ascertain the effects of different options.

ENVIRONMENTAL IMPACT ASSESSMENT

⁸ Motor Transport – Top 100 UK Road Transport Companies, 30 September 2004, Reed Business Information.

4.9 The environmental impact assessment will take account of the fact that LRUC will affect different vehicles and operators in different ways. It will be important to identify the impact that the rate structure and the fuel duty repayment scheme will have on emissions of greenhouse gases and other pollutants. It will also be necessary to consider the extent to which LRUC might discourage empty running, or might introduce technology to vehicles that could facilitate more fuel-efficient practices, for example through better fleet management. Work will be done on analysing all possible environmental impacts, so that these are taken account of when the LRUC rates are set.

EXISTING REQUIREMENTS ON HAULIERS

4.10 The following issues are relevant to the haulage industry. The Government is discussing them with industry representatives and will be taking them into account as it considers the implementation of LRUC:

- introduction of digital tachographs;
- operator licensing requirements;
- fuel duty regime;
- alternative fuel strategy/incentives;
- hydrocarbon oil: consultation on changes to excepted vehicle schedule; and
- Working Time Directive.

5

COMPLIANCE, ENFORCEMENT AND SANCTIONS

- 5.1** Responsibility for LRUC will lie with HMRC. It is envisaged that enforcement will be largely by means of a civil penalty regime, but with criminal offences for fraud and serious acts/omissions.
- 5.2** Compliance and communications strategies will be developed to cover pre registration, phasing and full implementation including information and education needs.
- 5.3** There will be an appeal system as for other taxes. Consideration of appeals will be done by HMRC staff rather than contractors. There will then be a right of access to an independent Tribunal.
- 5.4** There will also be access to an independent adjudicator.

6

MONITORING AND REVIEW

- 6.1** Further reports will be issued at appropriate stages in the development and implementation of LRUC.
- 6.2** Once LRUC is operational the LRUC Management Authority will receive management information from suppliers.
- 6.3** A full Post Implementation Review will be carried out.

PROGRESS AND CONSULTATION

7.1 In the November 2000 Pre-Budget Report, the Government first proposed to introduce a form of lorry road-user charging in the UK. The objective of the charge would be to ensure that lorry road-users in the UK contribute on a fairer and more equal basis towards the costs that they impose when using UK roads irrespective of their nationality. The Government recognised that, because UK lorry operators already contribute towards these costs, this should not involve increasing the tax burden on the UK haulage industry and so indicated that it would offer tax reductions for lorry operators when LRUC was introduced. In 2001 the Government made a manifesto commitment to ensure that all lorries using UK roads contribute on a fair and equal basis towards the costs they impose.

7.2 In the 2001 Pre-Budget Report, the Government announced a consultation with stakeholders, which was published in November 2001¹. This set out potential options for introducing LRUC, which would be offset by reductions in other taxes on lorry operators. The two options considered at this time were distance-based or time-based schemes.

7.3 The responses to the consultation, which were set out alongside Budget 2002 in Progress Report 1², showed overwhelming support for a distance-based charge:

- over 75% of respondents agreed with the Government's objective to ensure that lorry road users in the UK contribute on a fairer and more equal basis towards the cost they impose;
- over 90% of respondents agreed that time-based and distance-based charges were the main options for operating an LRUC; and
- over 80% of respondents believed that a distance-based charge would offer more potential to ensure that lorry operators contribute fairly and efficiently towards the costs that they impose in the UK. This included all haulage and rail freight associations, all environmental groups and all academic and research groups.

7.4 The Government announced its plans to introduce a distance-based charge in Budget 2002 and set out paving legislation in the Finance Act 2002 which provided high level enabling powers to allow the development of the charge.

7.5 The Government developed the plans further, and gave more certainty to hauliers, by specifying in Progress Report 2³ that the offsetting tax cuts would be applied through a fuel duty reduction, as discussed in Box 2.1.

7.6 In order to inform the design of the scheme, the Government commissioned a number of surveys. To provide information on the likely take-up of on-board equipment under different conditions, the Government commissioned a research agency to carry out interviews with UK lorry operators in late summer 2003. The survey also provided useful data regarding the haulage sector. In addition, a small-scale survey of overseas operators provided an indication of their reaction to the scheme.

¹ HM Treasury: Modernising the taxation of the haulage industry: A consultation document November 2001.

² Modernising the taxation of the haulage industry: lorry road-user charge: Progress report one April 2002

³ Modernising the taxation of the haulage industry: lorry road-user charge: Progress report two May 2003

7.7 Progress Report 3⁴, published alongside Budget 2004, announced the move towards the procurement phase of the programme and contained details of the reactions to the hauliers' survey.

7.8 Having established the remit for the scheme, the procurement process formally commenced with the Procurement Prospectus issued in May 2004. After an Open Day in June 2004, the Outputs Based Specification (OBS) was issued to a number of suppliers in August 2004 with the Preliminary Invitation to Negotiate, and HM Customs and Excise have started detailed discussions with the bidders who have been short listed to receive the Final Invitation to Negotiate.

7.9 In order to gather more information to inform future decisions, a discussion paper was issued in January 2005⁵, presenting options and setting out the Government's current thinking on key technical definitions. To supplement this a telephone survey of approximately 700 hauliers, including both UK and foreign companies, has been undertaken by independent analysts. Focus group sessions were also held with members of the British Vehicle Rental and Leasing Association (BVRLA), the Society of Motor Manufacturers and Traders (SMMT) and the Retail Motor Industry Federation (RMIF). A summary of the survey and the responses to the discussion paper will be published once the analysis is complete.

CONSULTATION WITH INDUSTRY

7.10 The Government has worked closely with representatives of the UK haulage and related industries throughout the development of LRUC. This has been an aspect of the development of LRUC from an early stage. The Government involved the Road Haulage Forum at every stage of development, and a dedicated sub group was formed, following the 2002 Pre-Budget Report, to meet on a regular basis. Members of the sub-group include the Freight Transport Association (FTA), the Road Haulage Association (RHA), the BVRLA, the SMMT, the Transport and General Workers Union (TGWU) and representatives of several UK haulage operators.

7.11 Officials have held presentation and consultation events with members of some of these organisations, including regional consultation sessions in Northern Ireland and Scotland. As well as regular meetings, the sub-group has also run workshops for members on specific technical issues. These sessions have been particularly useful in helping the Government to understand how businesses work and how LRUC will affect users. Ministers also meet regularly with industry representatives.

SCHEMES IN OTHER MEMBER STATES

7.12 The Government is assessing the operation of the existing road user charging schemes in Switzerland, Austria and Germany and is taking them into account in developing LRUC. It has also contracted with consultants working on the Swiss scheme to provide advice to the UK programme. Details of the current operations of these schemes are set out in the Progress Reports.

⁴ Modernising the taxation of the haulage industry: lorry road-user charge: Progress report three March 2004

⁵ Modernising the taxation of the haulage industry: lorry road-user charge: A discussion paper January 2005

8

SUMMARY

- 8.1** The Government remains committed to ensuring that all lorry operators, regardless of nationality, contribute on a fair and equal basis towards the costs that they impose in the UK.
- 8.2** To achieve the overarching policy objectives of fairness and efficiency, and to have a positive impact on transport and the environment, the Government has decided to introduce LRUC.
- 8.3** The Government has concluded that an automated distance-based scheme is the option that provides the best balance between meeting the stated objectives for LRUC and minimising the administrative costs, particularly for the haulage sector.
- 8.4** The specific technological solution required for such an automated LRUC scheme is currently being developed as part of a procurement exercise. It is expected that this process will result in contracts being awarded around the end of 2005, with equipment due to be installed in vehicles and charging due to be phased in from 2007-08, once the necessary systems have been built and tested.

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This is available from the HM Treasury website at:

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