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POLITICAL ACCEPTABILITY OF PRIVATELY FINANCED MOTORWAYS IN HUNGARY

Ágnes KOSZTYÓ and Ferenc MÉSZÁROS

Department of Transport Economics
Budapest University of Technology and Economics
H–1111 Budapest, Bertalan Lajos u. 2., Hungary
Tel: (36 1) 463 1061, (36 1) 463 1051
Fax: (36 1) 463 3267
e-mail: akosztyo@kgazd.bme.hu; fmeszaros@kgazd.bme.hu
website: www.kgazd.bme.hu

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Abstract

Based on a few research analyses, M1/M15 concession motorway project has been analysed, which was the first tolled and shared financed project in the CEE region with more or less success. The objectives of this analysis were to find answers to institutional questions about how to involve private capital into road infrastructure development in politically acceptable way, using a psycho-economic model. This paper starts with introduction and overview of the Hungarian concession motorway project's history. After the short description of the applied model, key actors are identified and described, as the politicians/regulators, transport providers and their interest groups, the public with interest groups and the media. This is followed by findings of in-depth analysis of the motivations and decisions, to be able to set up the stakeholders' characteristics and a way of decisions. This systematic description and the positive analysis of the different key actors lead to explanations of the situation and the causalities in occurrence of the Hungarian concession motorway project. The analysis criteria are problem perception, goals, information provision, effectiveness, equity/fairness issues, social environment, implementation process and finally the political and institutional setting. The conclusion attempts to give lessons to be learned, answers to institutional and regulatory questions and policy recommendations for decision-makers.

Keywords: psycho-economic model, motorway concession, transport institutions, political acceptability, Hungary.

1. Introduction

The turn of the century sets to the European Union several big challenges. The new European Common Transport Policy and the accession of new member countries assign new tasks to the Commission. Its efforts were consistently devoted to developing the basic philosophy of the Common Transport Policy in the last two decades. However, it has entered into a new era, the interest now has turned to issues of implementation. Responsible authorities in various member countries and on the European level follow the right strategies in implementation process. The aim of the authorities must be to guarantee that transport markets function properly. Where due to inherent problems of market failure this is not possible, they must

find a feasible and politically acceptable way to correct the market failure. This objective faces major political conflicts of interests several times. Furthermore, the institutional framework in certain countries may impose tight boundaries on what is feasible. Failures in attempts of liberalization are usually followed by a return to state intervention. Hungary also faces up to the consequences of transition period, from planned economy to the market one. This paper aims to emphasize barriers of political acceptability in the Hungarian context. We applied an integrated political model of acceptability called 'psycho-economic' approach [2] (combination of different theories of regulation and psychology) to analyse the implementation process of privatization and the failure to operate a private tolled motorway in Hungary (M1/M15). Defining key actors and their objectives, and examining them by using an analysis matrix of different relevant criteria lead to general findings and policy recommendations, with respect to successful policy implementation.

2. History of Concession Motorways M1/M15

In the 1990s Hungary performed an experiment with privately financed and operated motorways. This experiment pertained to two short stretches on the M1/M15 and on the M5. The M1/M15 motorways are parts of the TEN Helsinki Corridor IV and therefore parts of the connection between Budapest, Vienna and Bratislava. On the M1/M15 the amount of kilometres covered by the experiment was less than 60 (M1: 43 km, M15: 14km).

This project was the first privately financed and tolled infrastructure project in Hungary. The concession to build and operate the motorway was given to a private company ELMKA Rt., the financing was arranged by a consortium of international banks under the leadership of the European Bank for Reconstruction and Development in London; the credits were granted in USD and DEM. The role of the Hungarian state was limited to providing the necessary land, to build new feeder roads and to adopt measures for traffic calming on the secondary parallel roads; this meant a marginal share in total project budget.

It was planned that interest, amortization and operating cost of the project were to be totally financed out of user charges which were collected in HUF. Tolls were to be regulated according to a price-capping scheme, where tolls could be adjusted according to the increase in the consumer price index and exchange rate changes (USD/HUF, DEM/HUF), without prior permission of the authorities.

The first tolled sections on the M1 motorway were opened in 1996. Toll rate was 0.15 €/km for passenger cars. For vans, buses and HGV's this rate was multiplied according to their weights. The agreed toll rate from 1993 to opening date became insupportably high due to devaluation of the national currency and drop in real incomes.

However, it turned out that there were mainly Western foreign cars travelling long-distances, which used the tolled section. Most traffic, especially goods traffic, switched to secondary roads. Given the short distances mentioned before and

minimal time savings this is, perhaps, no surprise. The main differences in norm of foreign and domestic users were the frequency of travelling (frequent; non-frequent) and their purchasing power (strong; weak). Therefore, shortly after the M1 was opened for the public, on the part of domestic users several legal cases were brought forward against ELMKA. The first one was a municipal procedure, the second one a civil suit started by the lawyer of the Hungarian Automobile Club.

In the first case ELMKA was charged before the Hungarian Competition Council (HCC) with the accusation that it was exploiting a dominant market position and that its toll rates were too high. However, the HCC ruled that according to the Hungarian Competition Law the concession company was not guilty of abusing economic power, because their maximum levels were still lower than the ones fixed in the concession contract. This decision, however, went into appeal before the court of first instance. The court came to the conclusion that according to the Civil Code the toll rates were extremely high compared to other public services (the decision was based on the parallel, civil procedure at the civil court, see below). Another appeal before the court of second instance followed. This time the court ruled that the case had to be judged after the Capital Market Act (according to which the calculation method of toll rates was acceptable), not the Civil Code. Therefore the concession company was acquitted.

In the second case at the civil court it was ruled that according to the Civil Code the toll rates were unfair and extremely high, and that therefore the concession company had to pay back the excessive part of the toll paid exclusively by the lawyer of the Hungarian Automobile Club. The ruling has been interpreted by the media as a general obligation, it frightened lenders who suspended disbursement of the loans for financing subsequent section (M15), until additional sovereign guarantee was provided.

These legal proceedings (among other reasons) resulted in a substantial revenue shortfall for the operating company., In 1999 ELMKA finally went bankrupt and the government took over the responsibilities and liabilities, reduced toll rates immediately by 50% and rescheduled the debts. In 2000 the government replaced the toll system by a vignette system for the whole state-owned motorway network. The failure of this project led temporarily to political resistance to further privately financed infrastructure projects in Hungary; but these experiences improved the viability of the other concession motorway company, and politicians decided to call for concessions again.

The following factors determined the failure of the policy in case of M1/M15:

- The economic foundations were based on far too optimistic traffic forecasts; this was the reason of substantial traffic and revenue shortfall. (This emphasises the role of information provision in the implementation process.)
- The public felt unfairly treated because of the high toll rates, which led to two court cases against the operating company.
- The institutional framework in Hungary was very susceptible to what economists call ‘regulatory risk’. Regulatory risk refers to a situation where the private investor has already made his investments (in the form of ‘sunk

costs') and where accordingly he becomes exploitable by the government or the regulatory authorities. Infrastructure by its very nature is used by a large part of the (voting) population. As a consequence, politicians have an incentive to exploit the investor's weak bargaining situation by lowering user charges. But they can do this only in an environment without strong institutional safeguards against such an opportunistic behaviour (e.g. a strong tradition of protecting property rights, or strong and independent courts, etc.). Apparently Hungary's institutions at present do not offer enough safeguard against such a behaviour.

3. Scope and Objectives of the Analysis Matrix

The integrated model of political acceptability is not a formal mathematical model but rather a set of criteria and hypotheses that seem to be essential for analysing the institutions and the political processes involved in European transport policy-making. The partial approaches are frequently used in the non-economic social sciences and psychology. The developed 'psycho-economic' model is a synthesis of common ideas of the two input models. The first one [5] represents theoretical and empirical work concerning the acceptability of pricing measures in transport policy, they look at the problem from a psychological point of view, with several central variables in a heuristic model of acceptability of transport policies. The second one [6] is an attempt to combine the media system and cognitive aspects of media production and of transport policy-making into the positive theory of economic regulation. The model is based on the identification of key actors and interest groups in the policy process and relevant analysis criteria (the choice of criteria was led by empirical and theoretical work of the authors) [2].

The main goals of the model were to analyse the relations between the key actors and their impact on the implementation of a policy measure (see *Fig. 1*).

The key dimensions of the model are reflected in matrix structure, where each column corresponds to a particular actor of transport policy (x.1 – x.4) and each row contains a criterion (1.y – 8.y) (see *Table 1*).

At the last criterion (8.y) a decision tree scheme [1] was applied in the framework of the model of political acceptability, analysing the influence on implementation of transport policy. This scheme is based on the transaction cost theory and has already been proven very successful in analysing telecommunication policy, to contend the supposed factors which could be responsible for success or failure of a transport policy measure. The decision tree (*Fig. 2*) applied in the Hungarian context see below.

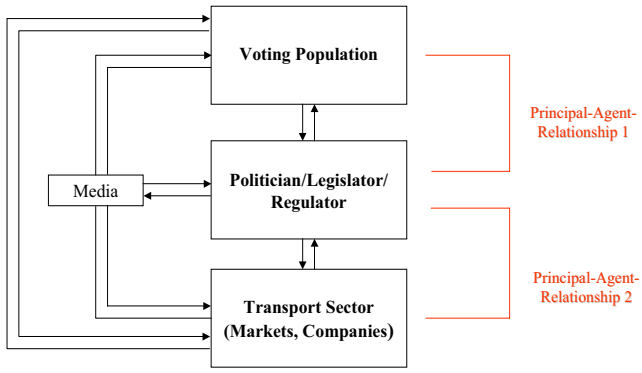


Fig. 1. Framework of political acceptability (key actors and relations) [2]

Table 1. Analysis matrix with key actors and criteria [2]

Key actors / Criteria	Transport providers, interest groups	Politicians/ Regulators	Public, interest groups	Media
Problem perception	1.1	1.2	1.3	1.4
Goals	2.1	2.2	2.3	2.4
Information provision	3.1	3.2	3.3	3.4
Effectiveness	4.1	4.2	4.3	4.4
Equity/Fairness	5.1	5.2	5.3	5.4
Social Environment	6.1	6.2	6.3	6.4
Implementation process	7.1	7.2	7.3	7.4
Political & institutional setting	8.1	8.2	8.3	8.4

4. Findings

The analysis [3] investigated the main coherences of events and actions of different key actors according to the analysis criteria.

In private investors' point of view profit maximization, on the part of lenders interests/debt service are standing in the centre of the problem perception. The concession company's main interest was revenue maximization, to cope with its debt service obligations [4]. If the assessed risks could be in any way decreased, because of any state contribution, private capital would be fighting for opportunities. Therefore, it means that public participation in such projects is more desirable towards reducing costs and increasing benefits of private investors. Politicians/regulators need to 'act' to create opportunities for private capital in financing transport in-

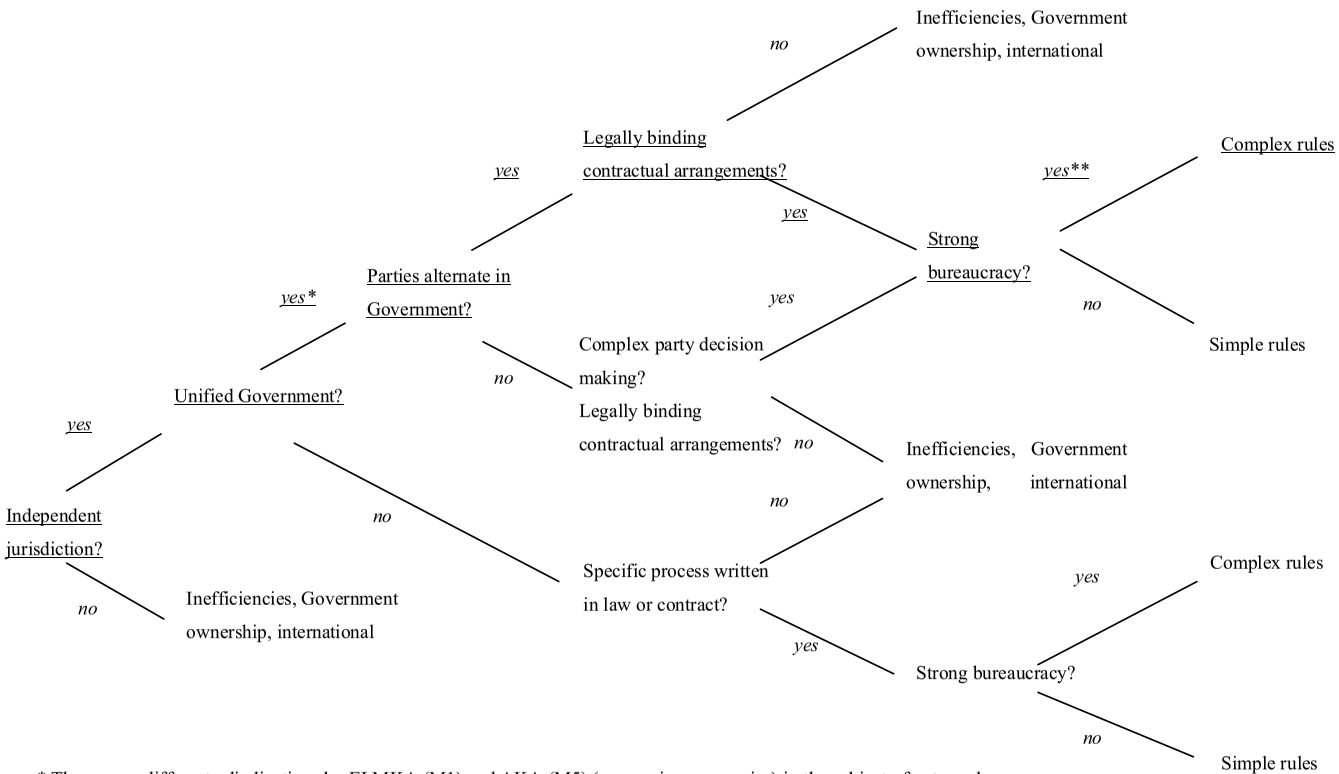
frastructure. Therefore, it can substitute stage budget resources and can improve the efficiency and effectiveness of infrastructure operation. Due to implementing private financing in transport infrastructure development, there were welfare losses regarding concerned and unconcerned citizens. Analysing the case of pricing policy, the welfare losses noticed were caused by the high toll rates, which caused a higher equality point than in ideal circumstances with reduced demand on the motorway, the remaining part of the traffic used the parallel primary roads in environmentally more sensitive areas (cities etc.).

The goals of the transport provider and its interest groups were to fight for and win the best conditions and assurances regarding the concession contract, nevertheless reach their proposed, planned aims and meanwhile arisen goals. In short, their proposed goals were to reach financial feasibility and bankability [4], since during the life cycle of the concession company they aimed state financial contribution in the motorway project. The main conflict – between the politicians/regulators and other key actors – was the degree of state contribution in the motorway development. Private investors wanted to get state guarantees on borrowed loans, independent professionals advised to the state decision makers that a minimal degree of involvement of state budget financial resources was needed by the development, but the politicians and regulators counteracted these initiations. International experiences and trends are showing on the long run the impossibility of the development of road infrastructure network with free admission to motorways, without toll collection and in addition, the de facto lack of state financial resources has made it easier for politicians to start to teach the public on the users pay principle to achieve their concept. The only failure was the inadequate level of public involvement in transport policy questions, especially in determining toll rates that considered the economic conditions and purchasing power of the population.

Important experience is that personal contacts and personal information exchange is more effective than the mass media propaganda, as they are the most popular means of politicians and parties before election periods.

Analysing the effectiveness of pricing policy (parallel with the success and fulfilment of planned profit maximization) it can be assessed that the introduced toll system was not able to meet the requirements of demand and supply, therefore the applied toll rates were much higher than the ones that could have been accepted by the customers. Evaluating the financing measure and regarding the Hungarian concept aimed at developing the motorway network with the help of private capital, the investors from the private sector could, in effect, consider the policy of private financing. This process was speeded up when the concessionaire of the M5 motorway started the operation of the second Hungarian concession motorway stage.

In case of the Hungarian study tendering procedure, the final discussions and signing of the concession contract and post-discussions were involved in the analysis of fairness regarding transport providers. The international tendering procedure



* There were different adjudications by ELMKA (M1) and AKA (M5) (concession companies) in the subject of extremely high toll rates.

**Especially in the period of parliamentary election.

Fig. 2. Decision tree scheme [1] applied in the Hungarian context

created a situation, in which many different, foreign and domestic bidders were involved. It can be established that the preparation of the tender satisfied all the possible consortiums, and regarding the financial value of the full project, the tendering procedure was fairly fulfilling the needs of international and domestic road constructing, operating and maintenance enterprises, foreign and national banks and the main lender, the EBRD.

The views of the stakeholders of different modes (passenger cars, HGVs, buses etc.) did not differ in a relevant way. Regarding private financing, they all greeted the construction of the new motorway stages (saving time compared with the estimated time gap in case of public financing method); they all aimed minimal toll rates to be paid when using the service of the transport provider. Considering the whole public, when the government bought out the concession company, it gave priority to users' short term interest against taxpayers' long term interest [4].

The advised thesis based on the Hungarian case could be that the transport policy implementation in case of private participants could have been got through easier because of additional financial resources and the need for efficient appropriation of private capital. In case of private financing and tolling there was a gradual implementation, but their elaboration and realization were carried out in a 'big-bang' way with several serious mistakes. The media played a significant role in implementing and accepting transport policies.

The Hungarian case study seems to verify and validate the alluded decision tree model [1] and contend the supposed factors which could be responsible for success or failure of a transport policy measure (see *Fig. 2*). The expectations can be quite fully confirmed, excluding the factor of national habits and norms, in this case the strong bargaining power at the table could probably be expletive.

5. Conclusions and Policy Recommendations

The legal and institutional system in Hungary was just transforming from a centrally planned economy to a market economy by the time the M1/M15 motorway project was initiated. But this framework was still insufficient and led to serious mistakes during the implementation of transport policies, increasing regulatory risks for private investors. That means after signing the concession contract and private investment (in form of sunk costs), the concessionaire became exploitable by the government and the regulatory authorities. The active political power was always stronger to influence decisions on transport infrastructure developments than professionals (e.g. disregarding the need for more state contribution stressed by independent professionals). Politicians had an incentive to exploit the investor's weak bargaining position by lowering user charges, they respected that infrastructure by its very nature is used by a large part of the (voting) population. This regulated market environment did not offer strong institutional safeguards against this opportunistic behaviour. Hungary still faces essential elementary changes in the institutional system. Due to the circumstances of transition in Hungary, insufficient

information and experience (too optimistic traffic and macroeconomic forecasts) led to unrealistic economic estimations and ultimate failure of the project. Information provision in the implementation process played an important role, but acceptability played only a minor role in this case. The public felt to be treated unfearly because of the applied pricing policy, what led to two litigations against the operating company [3].

Synthesising conclusions of presented and further analyses [2], the following general policy recommendations can be established. The public has to understand the problem a policy measure is intended to solve (problem perception), and to be convinced about its effectiveness. It is important for the decision-maker to spend resources on making his policies comprehensible to the audience. Otherwise, the policy measure will not be accepted. In addition he must explain why this measure is superior to other measures that may look more plausible at first glance. Politicians and transport managers have to take possible reactions of the media into account. In particular, they should avoid as much as possible everything which allows the media or opponents to negatively emotionalize the topic. This may mean, in some cases, that the policy measure has to be adjusted to prevent a negative media response. It may well be that this adjustment will lead to substantial departures from the 'first best' policy. Furthermore, politicians need to be aware of the fact that in cases, where positive welfare effects of a policy are not obvious, and where long chains of reasoning are necessary to explain the welfare gains, these are likely to go unnoticed in the public debate. In such a case people will judge a policy measure only by their individual gains and losses. Thus, a successful communication strategy needs to highlight the individual gains rather than focusing on a societal level. Finally, it is important to solve possible conflicts with certain interest groups, e.g. consumer protection groups before the launch of a policy measure, to take their arguments seriously and to involve them as much as possible in the implementation process.

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