ROAD FUNDS - 1: WHAT WENT WRONG?


INTRODUCTION

Ask anyone from the Ministry of Finance what they think about road funds and you will get two kinds of answer. Either they will lecture you on the evils of earmarking, fiscal inflexibility and the need for unified budget management or, if they have direct experience of road funds, they will roll their eyes and ask if you’ve read the latest audit report. These audit reports typically reveal poor financial management, misappropriation of funds, financial skulduggery and worse. Unfortunately, most first generation road funds did not provide a secure and stable flow of funds for roads. The early analytical work on road funds showed only a weak positive correlation between earmarking and the proportion of investment devoted to roads (Eklund, 1967). Hardly an encouraging result in countries where the road sector was already grossly under-funded.

FIRST GENERATION “EARMARKED” ROAD FUNDS

The term “first generation road fund” generally refers to road funds which:

- Have no oversight board.
- Rely on earmarked revenues, not always related to road use;
- Are typically managed by the national road agency;
- Have a weak legal basis;
- Do not have published financial rules and regulations;
- Are not subject to independent technical and financial audits.

Most were set up during the 1960s and 1970s in Africa, Asia, and Latin America, while a new batch were set up in Eastern Europe during the early 1990s.

RECENT EXPERIENCE

Recent reviews have highlighted the main weaknesses of these road funds (de Richecour and Heggie, 1995, and unpublished work by Talvitie and Sikow). There were five main weaknesses. The first, was lack of effective oversight. Even those road funds which had boards often did not meet and they were filled with appointees of the Minister or Permanent Secretary. This lead to unauthorized borrowing from the road fund – in one case, to finance civil service salaries and, in another, to support other public programs. Where there were effective, broad-based boards, the road fund would generally function quite well in spite of other problems. Second, most of these road funds relied on earmarked revenues which invariably took revenues away from other sectors. Not the best way to win friends in Cabinet! Furthermore, the earmarked revenues often included taxes which had nothing to do with road use. They sometimes included taxes on kerosene and home heating oil and, in Eastern Europe, typically included industrial turnover taxes. Third, day-to-day management was often unsatisfactory. Some boards employed a large number of staff (i.e., they became an employment agency for friends and relatives of the Minister and Permanent Secretary), or had no staff at all. In Ghana, the road fund was simply a bank account and the staff from the responsible ministry did not even keep a ledger account to check whether all the revenues attributable to the road fund had been paid into the account (which they had not).
Fourth, many road funds had weak, or ambiguous legislation and no published financial rules and regulations. In one case, the road fund was simply set up on the basis of a telephone call between the President and the Head of the Central Bank. Without a clear legal basis, the Ministry of Finance will often divert revenues for other purposes and the road fund will be unable to do anything about it. Likewise, without published financial rules and regulations, there is no guarantee that the funds will be spent on roads. Finally, many road funds do not carry out rigorous technical and financial audits to ensure that all revenues attributable to the road fund have been collected and paid into the road fund and that the funds have been disbursed to finance approved road works. My Research Assistant and myself used to regularly check the revenues paid into the road fund and used to just as regularly find that only about half the revenues due to the road fund had been paid into the account. I also doubt that some road funds are ever audited. I have tried for years to get a copy of the audit report on the Russian road fund – which they claim is regularly prepared by the Ministry of Finance – but without success.

There were also other problems (Heggie and Vickers, 1998). Some road funds were set up to only finance part of the costs of road works. The balance was meant to come from the general budget. However, once a road agency starts receiving some earmarked funds, the balance is hardly ever allocated from the general budget. Many road funds have no objective way of dividing funds between the different agencies entitled to draw from the road fund. In one case, the amount allocated for urban roads varied erratically from 16 percent of overall road fund revenues in one year, to 30 percent in the next. With such an erratic flow of funds, long term planning becomes impossible. Some road funds also had cumbersome withdrawal procedures. In one example, withdrawals had to be authorized by the Accountant General, on joint instruction from the Ministry of Roads & Highways and the Ministry of Finance. It often took months to pay contractors under this clumsy procedure.

**AUDIT REPORTS**

However, the real horror stories are found in the audit reports and the donor community deserves considerable praise for pressing to have such audits carried out. An examples is shown below.

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“The auditor discovered several problems in the way the fund did business …With the active participation of a Minister, the road fund:

(i) signed contracts which had not been tendered;
(ii) provided large salary advances to staff;
(iii) bought about 20 new saloon cars.

The Chairman of the road fund has been placed on administrative leave.”
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Box 1 summarizes selected excerpts from audit reports. They highlight the common problems which affect most first generation road funds. Often, there are no rules and regulations specifying how funds are to be managed, the road fund does not receive all the revenues assigned to it, funds are used to purchase assets which are given away as “gifts” to friends in high places, the money is spent on everything except roads, and financial management is so poor that the accounts cannot even be audited. One of my favorite quotes from an audit report says, “Funds were used to lay 40 mm of premix asphalt concrete on a newly constructed carriageway. But an audit site visit could not trace the newly constructed carriageway, and the street was found to be in pathetic condition,” and, from the same audit report, “A contractor was paid to construct three culverts – they could not be found during a site visit.”
Box 1. Excerpts from Audit Reports on Selected First Generation Road Funds

“No guidelines and accounting instructions were issued to enable effective management of the funds raised……..”

“Records of quantities of fuel sold … suggest that a substantial sum of money was collected from road users but was not paid into the road fund.”

“About $200,000 was used to purchase vehicles which were never delivered [to the road agency].”

“Funds were used to pay hotel bills, including substantial amounts billed as extraneous expenses.”

“Substantial sums were spent on refurbishing offices, purchasing 1,800 yards of carpet, carrying out repairs at State House and the Parliament building, etc.”

“We were unable to certify the accounts due to a general lack of financial information and lack of specific information on the revenue side.”

I have encountered some of these problems myself first hand. I recall being taken on a field trip by a Deputy Minister who, for a while, was responsible for overseeing a road fund. He explained how he had allocated a small sum of about $20,000 to a rural district council to help them carry out some emergency repairs to the roads in the district capital. A cheque for this amount was sent to the district Secretary who promptly checked into a four star hotel in the country’s capital and proceeded to spend the money on entertaining himself and his friends.

**RAIDS**

I was also on hand in a certain country the day after the Permanent Secretary raided the road fund and forced the staff, on penalty of being fired, to hand over a cheque for roughly $20,000. We believed that the funds were being used to pay for some of his friends to go on a shopping trip to a neighboring country. The Secretary of the road fund handed over the cheque, called an emergency meeting of the oversight board, and was instructed to cancel the cheque immediately. He did this and was then instructed to call in the press. The Permanent Secretary was subsequently moved to another posting.

**CONCLUSION**

To sum up, most first generation road funds did not generate a secure and stable flow of funds for roads. At best, they diverted revenues away from other sectors and undermined strict budget discipline. At worst they became nothing less than a den of thieves. Fortunately, although recent reviews uncovered the horrors of these road funds, they also showed why they failed to deliver a secure and stable flow of funds. This offered some hope. Once we understood why they did not work, we could start planning a new generation of road funds designed explicitly to overcome the weaknesses associated with first generation road funds. And, based on this analysis, we would also be able to open a dialogue with Ministries of Finance and the International Monetary Fund to try and agree on the key features which might make a new generation of road funds acceptable. The new second generation road funds will be the subject of the next article in this series.
REFERENCES:

