

Agenda

Advancing economics in business

There is no such thing as a free bus ride

With increasing tightness in government finances, sectors relying on financial support need, more than ever, to demonstrate that this support offers good value for money. This article, based on an Oxera report commissioned by the Local Government Association, reviews the value for money of the package of financial support for bus services in England and Wales outside London

In 2007/08, the package of public sector financial support to bus operators in England totalled £2.5 billion—a figure expected to have increased further in 2008/09.¹ The bus industry currently receives financial support through a number of channels, including fuel duty rebates, reimbursement of free concessionary travel, contracts with local transport and education authorities for services requiring subsidy, capital grants, and funds such as Kickstart. However, given today's unfavourable economic conditions and the continuing pressures on government finances, there is no guarantee that this level of spending will continue. Therefore, there is a need to review the current financial support to assess to what extent it can be justified, and whether it needs to be improved to deliver better value for money.

The Local Government Association commissioned Oxera to conduct an independent study on the value for money of the existing bus subsidy schemes in England (outside Greater London, where regulatory arrangements are different) and Wales. The study focused on how a sustainable package of financial support to the sector could be developed. As such, it aimed to raise key economic questions based on existing evidence—questions which are now a matter for policy-makers, industry and other stakeholders to take forward.

Current financial support for bus services

Financial support to the sector in England falls into seven broad categories.

- **The National Concessionary Fares Scheme:** free local bus travel for disabled people and people aged over 60, with bus operators paid for loss of income on a no-net-loss, no-net-gain basis.

- **London funding:** an indirect subsidy paid to operators providing services under contract to Transport for London (TfL). The budget for London funding is controlled by the Mayor of London, and is subject to oversight by the Greater London Authority (GLA).
- **The Bus Service Operators Grant (BSOG):** a payment from the Department for Transport (DfT) to bus operators, which offsets a high proportion of the fuel duty payable.
- **Local authority secured services:** local authorities make available for public tender routes which would not otherwise be commercially viable and which could not operate unless publicly funded. A subsidy is paid to the operator, normally under the terms of a net-cost contract under which the operator takes revenue risk.
- **The Rural Bus Subsidy Grant:** this grant is paid to local authorities to help support the provision of non-commercial rural services, and is targeted to support accessibility in rural areas.
- **Rural Bus Challenge and Kickstart:** these grant schemes are designed to help local authorities and operators introduce new and innovative services.
- **Capital spending:** bus services also benefit from capital investment to support bus stations, bus priority lanes and bus shelters funded by local authorities which receive support through either the DfT block grant or major schemes funding.

Table 1 below shows the amount of support for each of the above in England during 2007/08. It is notable that the BSOG and reimbursement of concessionary fares

This article is based on the Oxera report, 'Subsidising Buses: How to Get the Best from Taxpayers' Money', prepared for the Local Government Association, June 25th. Available at www.oxera.com.

Table 1 Public expenditure on buses in England

| Source of funding | 2007/08 (£m) | % |
|--|--------------|------------|
| Concessionary fares | 725 | 29 |
| London funding | 650 | 26 |
| BSOG (including London) | 413 | 17 |
| Local authority secured services (estimated) | 330 | 13 |
| Rural Bus Subsidy Grant | 56 | 2 |
| Rural Bus Challenge and Kickstart | 11 | <1 |
| Total (revenue) | 2,185 | 88 |
| Capital spending through local authorities | 300 | 12 |
| Total spending | 2,485 | 100 |

Source: Department for Transport (2008), 'Local Bus Service Support: Options for Reform', Consultation Paper, March.

account for nearly half of total public expenditure on bus services. The DfT expects this expenditure to increase further in 2008/09, with the BSOG rising from its 2007/08 level of £413m to around £439m, and the concessionary fares budget increasing from £725m to around £995m. Trends in funding for the reimbursement of concessionary fares, financial support for public transport (including administrative costs, the Rural Bus Subsidy Grant, and Rural Bus Challenge funding) and the BSOG in England outside London are illustrated in Figure 1. As can be seen from this, support for bus transport has increased over the past ten years by more than 50%, and expenditure on concessionary fares and the BSOG has more than doubled.

Value for money of the existing support package

There are two strands to assessing the value for money of current support to the bus sector.

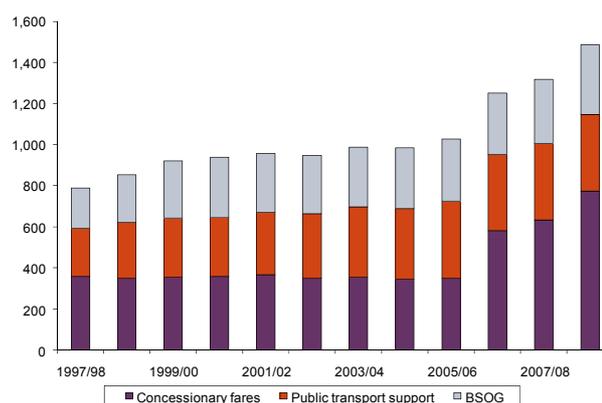
- **Fulfilment of public policy objectives:** government (in its widest sense) intervenes in the bus market through regulation, tax rebates and subsidy, in order to deliver its objectives. Therefore, one key aspect of any value-for-money assessment is the extent to which the current package delivers against these objectives, which are likely to include policies to address congestion, climate change and local pollution, to improve access to local markets, and to assist vulnerable groups.
- **Efficient delivery of outcomes:** while ensuring that public policy objectives are met, any subsidy package must also be operationally efficient and well targeted

in order to deliver maximum benefits at the lowest possible cost. The level at which incentives are set in order to deliver these outcomes most efficiently (be it local, national, or both) will depend on the type of objective under consideration.

An assessment of each aspect of the support package, in terms of the objectives it is intended to meet and the extent to which it does so, delivers some useful insights.

BSOG. The DfT pays the BSOG to registered bus operators on the basis of their fuel consumption. It is designed to offset a high proportion of the duty paid by bus operators on the fuel they use. As a result of recent changes to the scheme, the exact proportion rebated is currently falling from its previous level of around 80%. The subsidy does not provide operators with a direct incentive to increase passenger numbers, but may lead indirectly to an increase in bus usage by subsidising lower fares and/or more extensive bus services. The evidence suggests that, through 'blanket' support for bus services, the BSOG delivers benefits in excess of its costs.² However, if this subsidy were to provide direct incentives for increasing bus usage, the scheme might achieve even greater benefits.

Furthermore, the scheme operates by reducing fares with the aim of inducing shift from cars to buses, irrespective of local needs. In practice, however, while this objective is driven largely by the need to alleviate local congestion and pollution, the rate of reimbursement under the BSOG is set nationally, with no scope for discretion in its application locally. Insofar

Figure 1 Public sector expenditure on bus services in England outside London (£m, 2007/08 prices)

Note: ¹ Figures estimated using data sourced from the budget for reimbursement of concessionary fares 2008/09, and 2008/09 BSOG data provided to Oxera by the DfT in June 2009. For public transport support, expenditure in 2008/09 was assumed to remain at the 2007/08 levels. ² BSOG data from the DfT is available for Great Britain only, and was allocated to England outside London on the basis of local bus kilometres. Source: DfT (2009), 'Transport Statistics Bulletin: Bus and Light Rail Statistics GB: Q4 2008', March. DfT (2008), 'Transport Statistics Great Britain 2008 Edition', November.

as lower fares are necessary to increase local accessibility and social inclusion, they may be better handled through the provision of cheaper concessionary travel, over which local authorities do have a degree of local discretion.

Since the BSOG is directly related to fuel consumption, in that it rebates almost all of the fuel duty paid by bus operators, it provides little or no incentive for fuel efficiency and the reduction of carbon emissions. Recent changes to the BSOG are intended to increase the incentive for fuel efficiency through the implementation of a tiered rate, and through additional incentives to encourage operators' use of low-carbon buses. However, this is an imperfect mechanism in that it fails to ensure that bus operators face the same incentives to economise on fuel as operators in other transport modes.

Therefore, although the BSOG does result in greater bus usage, better targeting of the subsidy might result in greater benefits. Such targeting could be achieved by devolving to local authorities the management of at least a proportion of the funds received through the BSOG, to enable them to choose the most appropriate measure through which to address local congestion and pollution. The remaining proportion of the subsidy could be targeted towards local schemes to reward those operators achieving the greatest carbon savings per unit of expenditure. Such a split would be necessary to ensure that local issues (eg, congestion and pollution) are addressed at the local level, with the issue of carbon emissions—which has national or international significance regardless of where the emissions occur—being targeted through national policy, albeit through delivery of the best locally determined schemes at the local level. This would have the added benefit of removing the present fuel subsidy, thereby ensuring that bus operators face the same tax incentives to minimise costs and increase fuel efficiency as other road users.

Concessionary fares. Under the Concessionary Bus Travel Act 2007, the national concessionary bus travel scheme provides for off-peak travel free of charge for older and disabled people on local buses anywhere in England. Bus operators are reimbursed by local authorities, passenger transport executives (PTEs) and other travel authorities, under a 'no better, no worse-off' arrangement.³ This demand-side subsidy is intended to improve accessibility for older and disabled persons by providing them with an incentive to make greater use of local bus services. Studies such as Baker and White (2008), O'Neill (2007), and Rye and Mykura (2008) show that the scheme gives rise to a significant number of additional journeys undertaken by the eligible population.⁴

However, there is also evidence that the scheme is targeted too widely, benefiting many people on higher incomes, many of whom also have access to cars (ie, those unaffected by social exclusion and accessibility issues prior to the introduction of the scheme). For example, Rye and Mykura (2008) find that, in Scotland, 43% of non-car-owning respondents and 53% of car-owning respondents reported making more trips by bus after the introduction of free concessionary travel. There is also evidence from Baker and White (2008) that pass holders are now younger, better off and more likely to be car owners.⁵ This raises the question of whether the scheme does indeed represent value for money, and whether it should be better targeted at those people who genuinely need it.

Secured services. Local authorities may choose to secure the provision of bus services on routes which would not otherwise be commercially viable, and which could not operate without local government funding.⁶ These services are often secured through competitive tender, with the exception of contracts below a minimum threshold. In general, secured services are well targeted, although there seems to be some uncertainty about whether the tendering process could be more efficient. The de minimis level of subsidy below which tendering is not required is, in England, currently higher than that prescribed under European Commission Regulation 1370/2007.⁷

The experience of some local authorities, such as Devon and Essex, has shown that combining tenders for secured services with those for school and social transport can be successful. However, the Office of Fair Trading (OFT) has criticised the practice of 'packaging' tenders together as being anti-competitive,⁸ although it does say that 'cost savings achieved by bundling services might be used' to justify the practice. Nevertheless, the uncertainty created often means that local authorities are reluctant to do this, even where there would seem to be clear benefits to local taxpayers.

Rural Bus Subsidy Grant, Rural Bus Challenge and the Kickstart Bus Challenge Competition. The Rural Bus Subsidy Grant is paid to local authorities to help support the provision of non-commercial rural services, and is targeted to facilitate accessibility in rural areas. The Rural Bus Challenge is an annual competition in which local authorities bid for funding for schemes aimed at stimulating innovation in the provision and promotion of rural public transport, and at improving quality and choice across the country.⁹

The Kickstart Bus Challenge Competition was launched in 2004, incorporated within the Bus Challenge programme, with an emphasis on social inclusion.

Schemes funded under Kickstart must represent partnerships between local authorities and bus operators, and aim to be commercially viable or to have a guarantee of local authority revenue support, if required, at the end of the funding period. There is evidence to suggest that most of these forms of support are well targeted and therefore worth continuing.¹⁰ However, they all share the same focus—namely, accessibility. As there is considerable risk of duplication of effort, administration and subsidy, there may be a case for combining some, or all, of these elements into a single form of support.

Conclusions and recommendations

The review of the current financial support for bus services indicates that there is a need for action to improve the targeting of the existing funding package to ensure that it delivers value for taxpayers' money. Similar conclusions have been reached by the Eddington Transport Study and a recent report for the Welsh Assembly Government.¹¹ In particular, the following questions regarding the various components of current financial support for bus services need to be addressed, questions which are now a matter to take forward in the context of the proposal by the OFT to refer the local bus market outside London to the Competition Commission.¹²

- The long-term sustainability of the national concessionary fares scheme, which is too widely targeted to ensure the effective and efficient fulfilment of the accessibility objective.
- The environmental implications of the BSOG, which, while an important element of financial support to operators, also acts as a disincentive to reduce carbon and polluting emissions, particularly in comparison with incentives under the fuel duty system for other modes of transport.
- The lack of importance accorded to specific local conditions and priorities (particularly with regard to congestion and local pollution) under the centralised funding currently applicable to most forms of public support.
- The multiplicity of types of support to the sector, some of which appear to focus on overlapping policy objectives, and could be combined into a single source of support to improve efficiency.
- Current contracting and tendering arrangements for secured services, which can deter high-quality operators from tendering to provide combined secured services, school and social transport, to local authorities.

The Oxera report makes a number of recommendations in relation to these issues, outlined in the box below. These recommendations are aimed at improving the value-for-money case for financial support for the sector at a time when, whichever party wins the next general election, government expenditure is likely to be subject to stringent review.

Oxera policy recommendations

To improve the value for money of the current financial support package for bus services, Oxera has suggested the following policy recommendations.

- **Better value for money could be achieved by removing the fuel duty rebate for bus services (the BSOG). A proportion of the additional duty collected might be better devolved to local authorities to provide and support enhanced local bus services, thereby addressing local congestion, pollution and social priorities. This would provide the funding support to accompany the partnership arrangements envisaged under the Local Transport Act 2008.**
- **Under the existing framework, the remainder of the BSOG might be better allocated to those local authorities proposing bus schemes or other measures to generate measureable (and therefore auditable) reductions in transport carbon emissions. The social cost of carbon is the same regardless of where it is emitted, but such an initiative would at least allow local stakeholders to propose the best solutions in their own locality, and would ensure the allocation of the funding necessary to support these principles.**
- **The National Concessionary Fares Scheme is an inefficient and costly means of delivering public policy objectives. Better targeting could generate savings which could be made available to local authorities to ensure support for lower-cost travel for the scheme's intended beneficiaries, through the provision of locally prioritised, additional concessions.**
- **There are currently several subsidy streams aimed at improving accessibility. Value for money could be improved if these were combined into a single fund, with local authorities having flexibility over expenditure—albeit with statutory safeguards to ensure that minimum standards (for example, with regard to the engine standards) are met.**
- **Efficiency savings could be achieved through improvements to current tendering practices, including raising the de minimis level for the tendering of secured services in England to match that required under European legislation, and combining the procurement of secured services with procurement for education and social services. These measures might also encourage operators offering higher quality to bid for contracts.**

Source: Oxera (2009), 'Subsidising Buses: How to Get the Best from Taxpayers' Money', report prepared for the Local Government Association, June 25th.

¹ Department for Transport (2008), 'Local Bus Service Support: Options for Reform', Consultation Paper, March.

² A 2005 study for the UK Commission for Integrated Transport (CiT) suggested that the £274m received through the BSOG increased passenger numbers by between 3.5% and 10.8%, reduced fares by up to 32%, and increased service frequency by up to 19%. In its consultation paper on the BSOG, the DfT commented that the grant, in its current form, offered good value for money. It estimated that bus usage is around 6.7% higher than it would be if the BSOG were to be withdrawn completely, while services are 7.1% higher and fares are 6.5% lower.

³ Reimbursement includes compensation for lost revenue, as well as any net additional costs resulting from the concession, such as administration and implementation costs, revenue forgone from non-concessionary passengers displaced from the bus service, and the extra costs of carrying those pass holders who otherwise would not have travelled on the bus. See Department for Transport (2009), 'Concessionary Travel for Older and Disabled People: Guidance on Reimbursing Bus Operators', January 13th.

⁴ Baker, S. and White, P. (2008), 'Impacts of Free Concessionary Travel in English Rural Regions from April', Sixth Transport Practitioners' Meeting, Reading, July; O'Neill, J. (2007), 'The "Free Bus Pass": Changing Geographies of Travel', BA Human Geography Thesis, May 2nd; Rye, T. and Mykura, W. (2008), 'Concessionary Bus Fares for Older People in Scotland—Are They Achieving Their Objective?', *Journal of Transport Geography*.

⁵ Baker and White (2008), op. cit.

⁶ An Atkins report of 2005 estimated that 20% of all local bus service operations in England outside London were supported by local authorities. See Atkins (2005), 'Monitoring Local Bus Service Tenders in England', Final Report, May 13th.

⁷ Regulation (EC) 1370/2007 of 23 October 2007 on Public Passenger Transport Services by Rail and by Road and Repealing Council Regulations (EEC) No.s 1191 and 1107/70 [2007] OJ L 315/1.

⁸ Office of Fair Trading (2003), 'The Transport Act 2000 and The Transport (Scotland) Act 2001: Guidance on the Competition Test', October.

⁹ Department for Transport (2005), 'Introduction to Bus Grants', March 23rd.

¹⁰ Department for Transport (2005), 'Evaluation of Rural Bus Subsidy Grant and Rural Bus Challenge', October 27th; Bristow, A.L., Enoch, M.P., Zhang, L., Greensmith, C., James, N. and Potter, S. (2008), 'Kickstarting Growth in Bus Patronage: Targeting Support at the Margins', *Journal of Transport Geography*, **16:6**, 408–18.

¹¹ HM Treasury (2006), 'The Eddington Transport Study: The Case for Action: Sir Rod Eddington's Advice to Government', December; Ministerial Advisory Group (2009), 'Phase 2 Report on Transport', prepared for the Welsh Assembly Government.

¹² Office of Fair Trading (2009), 'OFT Proposes Referral of Local Bus Services to Competition Commission', press release, August 20th.

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Gunnar Niels: tel +44 (0) 1865 253 000 or email g_niels@oxera.com

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