# Consultation response

**To:** **Department for Transport**
**Local bus service support, options for reform**

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**Contact point:**

Tim Larner
***pteg*** Support Unit
Wellington House
40-50 Wellington Street
Leeds
LS1 2DE
0113 251 7204
info@pteg.net

## 1. Introduction

1.1 ***pteg*** represents the six English Passenger Transport Executives (PTEs) in England which between them serve eleven million people in Tyne and Wear ('Nexus'), West Yorkshire ('Metro'), South Yorkshire, Greater Manchester, Merseyside ('Merseytravel') and the West Midlands ('Centro'). Transport for London (TfL) and Strathclyde Partnership for Transport (SPT) are associate members of the group, though this response is not directly relevant to SPT and does not reflect TfL's view.

1.2 The PTEs plan, procure, provide and promote public transport in some of Britain's largest city regions, with the aim of providing integrated public transport networks accessible to all. The PTEs (including SPT) have a combined revenue budget of about a billion pounds a year, with a further £300m of capital expenditure, and are funded by a combination of local council tax and grants from national government. The PTEs are responsible to Passenger Transport Authorities (PTAs) made up of representatives of local councils in the areas they serve.

1.3 PTEs welcome this review of arrangements for subsidising bus services and, in particular the reform of the arrangements for distributing Bus Service Operators Grant (BSOG). This is a complex area and the consultation considers the issues and options with different degrees of analysis. It also signals the likelihood of further consultation in related areas, notably the payment and funding of concessionary travel reimbursement. Our response does not, therefore, express firm views in many of the areas where DfT is seeking a response. We would welcome the opportunity to continue engaging with Government on some of the big issues raised by the consultation.

## 2. Issues and concern relating to this consultation

2.1 We consider the paper raises some very fundamental issues which will need to be clarified before PTEs can respond, in a detailed manner, to the many specific and relevant questions set out in the consultation. Whilst we have attempted to deal with all the detailed questions (see Annex 1), we deliberately refrain from making definitive responses. We set out below some of these 'big picture' issues that are raised by the consultation and trust that this is helpful in pointing the way forward to find a way of clarifying the framework within which the payment of bus subsidy sits.

<u>The place of fuel taxation in the context of a 'modally agnostic' approach to transport planning</u>

2.2 The Government has made clear in the last two years that it wishes to adopt a 'modally agnostic' approach to transport - so that the best solutions to problems are in the context of city and regional, national and international networks, irrespective of the mode of transport being promoted. We wholeheartedly agree with this approach.

2.3 In our view it is essential, if this approach is to operate successfully, that there are no hidden subsidies that favour a particular mode of public transport, or means of powering public transport. At present tram, ferry, rail and air operators pay no duty on fuel. Neither do users pay VAT. We fully support this general policy. The exception to this policy is the treatment of buses and coaches, where the pump price is paid for fuel with about 80% of duty rebated through BSOG. In the case of coaches there is a trade-off, with the provision of concessionary travel at half price for certain groups of passengers being delivered through BSOG.

2.4 We feel it would be helpful for the general policy on fuel taxation on public transport to be made clear prior to the Government coming to a firm view about the options set out in the consultation paper.

2.5 One of the main arguments against BSOG is that it is an incentive to burn fuel. Clearly this is unhelpful in the context of an environmental policy post-Stern. However, it also needs to be recognised that the rebated duty forms a significantly smaller element of the pump price than it did a few years ago. With big rises in the costs of oil-based products, the whole of the bus industry has been forced to reconsider the value of investing to reduce fuel consumption. Those financial arguments will grow further as oil costs rise with some analysts[1] now predicting $200 per barrel prices within the next two years (a further relatively short-term rise of more than 50% rise over current prices). With these rises possible, indeed likely, we think it is questionable whether investment in new technology combined with effective and efficient regulation does not offer a better solution than major changes in the payment of BSOG. Having said this we would very strongly support accelerating the introduction of bus-based technologies that reduce dependency on oil and mitigate climate change. Part of the solution to this challenge may be to use higher rates of subsidy to support the introduction of low carbon buses (LCBs) (see detailed comments in paragraph 2.10), but this must not be at the expense of conventional-engine services.

<u>The level of Government commitment to future levels of grant</u>

2.6 This question is closely linked to the previous one. It is impossible to respond to questions about the payment of the grant in the future without some understanding about future funding levels, and a clear commitment that Government will not use this change to reduce the level of support for bus services and their users. We believe it is essential that the basis on which any future grant will be paid are made very clear. Commitments reaching well into the future are necessary to give operators and local authorities the clarity they need to make key investment decisions and decide about the financial sustainability of the network and fare offer.

[1] BBC News, 'Oil price 'may hit $200 a barrel'', 7 May 2008, <http://news.bbc.co.uk/2/hi/business/7387203.stm>, viewed 12 May 2008

The national objectives of supporting local bus services

2.7 The consultation paper asserts that BSOG provides good value for money, but it does this in the absence of national policy context. Some of the alternatives put forward clearly shift the weighting of different policy objectives. Environmental, integration or service quality objectives are, for instance, given greater prominence. The relative balance of achievement of national and local objectives is also not clearly spelt out. This may assist in improving value for money in the future, but without a clear framework, it is difficult to assess the benefits other than through economic appraisals (which often fail to give due weight to social and environmental considerations).

2.8 Whilst there is an important national context, most of the policy benefits from supporting bus services are local in nature, with bus services typically serving trips between two and five miles in length. ***pteg*** would therefore argue that, in principle, local transport authorities are best placed to maximise value for money from public subsidy by channelling all forms of subsidy though those authorities. ***pteg*** hopes that, though publication of transport Green and White Papers planned for later this year, a clearer framework for policy towards the support of local bus services will emerge.

The scope for better achievement of national and local objectives through more sophisticated distribution of BSOG

2.9 The current distribution of BSOG has merits because of its simplicity and therefore the low associated administrative overhead. Several of the options put forward in the paper suggest different, and often more complex, means of distributing BSOG. Some of the approaches used attempt to redistribute a fixed amount of money, others indicate a possible increase in subsidy to achieve other goals. In general we agree with the policy objectives, though we do have some reservations about whether these are best delivered through the changes suggested, particularly where these introduce significant complexity (see Annex 1). Fundamental to the issue is whether increasing subsidy for some vehicles, or services or individual bus journeys, leads to a subsidy reduction for others. Whether some form of safety net mechanism should apply is also an important issue. We would pose, for instance, the following supplementary questions:

- If grant is to be increased for low carbon vehicles, is it envisaged that the rate for 'normal carbon' vehicles will be left unchanged or reduced?

- If the aim is to achieve full take up of better specified buses, will the higher rate be maintained in the long term? How will the full operation of these better-equipped buses to benefit bus users be incentivised, rather than just vehicles in the fleet having the requisite equipment on board?

- Is BSOG the most effective way to incentivise early take-up of better equipped buses, or are capital grants more effective?

- If payment is to be made by passengers, should this recognise that the current PSA is a proxy (for delivery of higher level objectives) and incorporate differentiated rates, for instance to reflect that peak passengers may be worth more than off-peak ones in terms of policy delivery?

2.10 We feel these are relevant questions that should be embraced in coming to a view about the future of BSOG.

Transitional arrangements

2.11 There is little discussion in the consultation of the transitional impacts of changes in payment regime, and we consider this to be a vital part of any decision to reform subsidy payments. There would inevitably be winners and losers in any change that does not involve an increase in the level of funding – for operators, local authorities and passengers. We feel consideration should be given to gradual changes over a number of years, with 'safety net' payments where large changes are required to change payment regimes. We would like to discuss these issues further in the context of the Department's specific policy proposals.

Possible implementation options relating to devolved grant

2.12 ***pteg*** is interested in pursuing further discussion about the possible devolution of BSOG to Local Transport Authority (LTA) level. In the case of an authority adopting a Quality Contract (QC) Scheme there would be much merit in BSOG being devolved. We can envisage the same arrangements applying to a PTE introducing comprehensive partnership arrangements, possibly structured around a Quality Partnership Scheme (QPS).

2.13 Whilst we accept the arguments for devolution in the context of QCs, ***pteg*** considers that devolution options would be best delivered though bi-lateral discussions with DfT, and in consultation with local bus operators. We would not favour an enforced devolution taking place for all PTEs (or indeed all LTAs). Further work is required to consider the full implications of this change.

BSOG in the context of the developing EU carbon trading system (ETS)

2.14 Consultations are currently underway on the reforms to the current ETS in preparation for 2103. It would appear that neither the Commission nor the UK Government is yet convinced about the value of including the land transport sector within the ETS, and that further study will take place in the next few years. It may be premature to institute radical change to the fuel taxation system if other effective means can be found to secure significant reductions in greenhouse gas emissions within the public transport sector though either carbon trading or through vehicle regulation.

## 3. A suggested way forward

3.1 We sympathise with the Government that this is a difficult area in which to make short-term progress. Change has been promised in this area for a number of years, and the implications of effecting those changes have understandably led to decisions being deferred. We suggest that no major decisions are made until the full consequences are better understood. We are concerned that the analyses presented may not have fully worked through some of the unintended consequences. In particular, we would want better to understand the Government's commitment, or otherwise, to the current funding policy of rebating increases in fuel duty before expressing a firm view on many of the options outlined. Worthwhile reform will be much harder to achieve if part of the purpose of that reform is to control future levels of overall funding.

3.2 However, we can see the value of speedy action in some areas. There is clear merit in supporting the early introduction of LCBs, and this may include changes to the subsidy regime to support these changes. It may, however, be better to tackle this through capital grants to accelerate the point at which LCBs become commercially viable, through a combination of cheaper technology and higher diesel prices. Similarly there is value in some of the more modest administrative changes being introduced in advance of major changes.

3.3 We would also wish to see clear strategies for the development of ITSO smartcard pass readers on all buses, and would welcome being involved in the development of any national strategies. A similar strategy is needed to ensure widespread take-up of real time information alongside the setting of national technology standards. The funding mechanisms to deliver speedy uptake of these, now proven, technologies will form an important part of these strategies.

3.4 Whilst we welcome the opportunity to consider all forms of bus support in the same review of policy, we would wish to consider the issue of funding for concessionary travel in the context of the review DfT proposes to undertake in the coming months. In our view, it is premature to comment on this issue in the context of ongoing work. We would welcome ongoing engagement with DfT on this important issue.

## Annex 1 – Responses to detailed questions set out in the consultation

This Annex considers the questions embedded in the consultation paper and sets out the initial views of ***pteg***. It should, however, be read in conjunction with the main part of the consultation response (pages 1 to 5). In that part of the text, we have set out some key concerns that in some cases override the detailed points we record here. Where supportive comments or constructive criticisms are offered, it is in the context of a decision in principle to proceed with the reforms indicated. It does not necessarily indicate total support for the principle.

For instance: we support the concept of paying grant for services involved in a quality contract. That does not negate, however, the overriding view expressed in paragraph 2.3 that bus fuel taxation should be based on same principle as all fuels used by other modes of public transport and bus services in the rest of country.

### Proposal 1: BSOG rate capped at a minimum fuel efficiency level

*The most appropriate fuel efficiency level at which to cap BSOG payments, and how this might evolve over time?*

This proposal is likely to impact particularly on small operators. We would expect the large operators (who typically provide about 95% of the services in PTE areas) to adjust their fleets across the country to ensure that their subsidiaries avoid the impact of the cap. Were this to happen, operators would tend to move older vehicles (with better fuel performance) into PTEs areas, where traffic congestion and frequent-stop/start conditions tends to increase fuel consumption. Overall, depending upon where the cap was set, we would see little merit and significant risk with this option.

*Whether there should be different rates for urban and rural services? This might allow the different characteristics of operations to be reflected but would be more complex and difficult to administer.*

Clearly a different rate for urban and rural operation would mitigate the risks we describe above. However, the detail of the arrangements would be critical. There may be as much difference between 'big city' and 'small town' performance of vehicles as between 'typical urban' and 'rural'. We would request further information on the detail of the DfT's proposal in this area, and exemplifications as to how it is expected to impact on different operators and areas.

### Proposal 2: New arrangements for Low Carbon Buses

*The most appropriate definition of LCBs. A recent definition defined an LCB as a bus which had 30% lower CO2 emissions than a standard diesel bus of the same seat capacity. Is this still appropriate?*

*What reductions in the costs of LCBs could be expected as volumes of production increase?*

*How robust are the CO2 reductions from the current round of LCBs?*

*Are any further changes needed to allow for alternative fuels, (biodiesel or road fuel gases which already command a rate of 100% fuel duty) and to encourage the use of vehicles with cleaner emissions?*

We would be interested to explore the degree to which differential rates of BSOG could be used to encourage the introduction of LCBs. We have been involved, with DfT, in the work of the Low Carbon Vehicle Partnership. This work indicated that BSOG may be an important factor in making LCBs a long term commercially viable option for operators, but the work was not conclusive. Furthermore the financial case for introducing hybrid vehicles is changing rapidly as the price of diesel rises and the technology matures.

Above all, we are concerned, at this stage to understand whether Government intends to put 'new money' into BSOG to promote LCB development. We would not favour a re-allocation of the funding to produce differential rates, but would expect the right financial and regulatory incentives to be put in place to encourage better environmental performance of the UK bus fleet, drawing on the experience of previous technological changes, such as the introduction of low-floor vehicles and low-sulphur diesel.

We do not currently have the technical advice to respond to these questions in detail, but agree that making a properly informed judgement about the market pricing of LCBs, in volume production, play a vital part of setting an appropriate differential rate for LCBs. We would, however, question the suggested single threshold of 30% reduction in $CO_2$ emissions. It may be that a much more finely graduated set of rates is needed (along the lines now used for car taxation purposes) to ensure that there is a continuing incentive for the vehicle industry to maintain development investment in LCBs. The recent work of the low carbon bus partnership indicated that a 40% reduction is possible using hybrid technology. We consider that such reductions may be worth aiming for using taxation and other incentives.

***Proposal 3: Devolve BSOG payments to areas undertaking Quality Contracts including London***

*Should devolution be accompanied by certain targets or should decisions on targets for achieving value from spending be decided locally?*

***pteg*** agrees fully with this policy proposal in principle.

*How should future levels of support be decided? Should they increase in line with other subsidy payments, patronage or inflation?*

We consider there must be consistency in policy setting. Whatever means is used to set the national fund for BSOG, or its successor, should be used to determine the distribution of that fund geographically.

*On what timescales would it be possible to achieve devolution?*

Initially, this a matter for TfL and other London stakeholders to determine in conjunction with DfT. As regards QCs, we believe that the new regime should operate immediately with the implementation of the first Scheme.

*How should the starting level of subsidy be determined?*

***pteg*** believes the policy principle set out above should be employed.

**Proposal 4: Tiered Rates of BSOG**

*Whether there is a case for tiered rates of BSOG to apply also to use of buses which meet particular criteria for emission of air pollutants and green house gases and how this could be effectively designed.*

We can see the merits, at least in principle, for tiered rates. We are, however, concerned this would introduce distortions into the process. At the margin, it would be in an operator's interest to declare a better rate of fuel consultation than had actually been achieved in order to achieve a higher rate, even though he would have to declare a lower total amount of fuel used. We can therefore see significant practical problems with this approach.

*What level of BSOG rate differential for smartcard ticketing and GPS systems would strike the appropriate balance between providing a strong incentive for these to be rolled out, and avoiding significant disruption to existing services?*

*What would the cost be (i) per bus for readers (ii) for the back offices of installing such systems? What minimum level of 'back office' support for smartcard ticketing and GPS should be required?*

*How do these costs change if Smartcards and GPS systems were both installed together? And could they use the same 'back office?*

*How could the installation of GPS and smartcard ticketing systems best be verified and audited? Could information from ITSO Co. or other bodies about registration be sufficient for smartcard verification? Could the use of GPS be verified by liaising with the Traffic Commissioner to establish whether high quality punctuality data was available?*

*Would universal coverage be necessary or would a high proportion of vehicles being fitted be sufficient?*

*Should special arrangements be made for smaller bus operators?*

*How quickly could the supplier market respond to a significant increase in demand?*

*Would the introduction of GPS into more vehicles provide a catalyst for increased use of real time information systems by both local authorities and operators?*

*The case for requiring operators to provide patronage data direct from the smartcard system and potentially GPS data, to an agreed specification, direct to DfT?*

We feel that there is a lot of merit in addressing these questions and we are happy to put at DfT's disposal the lessons already learned by PTEs - including cost estimates for large-scale implementation, and those involved in setting up large 'back office' systems. However there are a number of key issues that need to be clarified in assembling a business case. These include the following issues:

- A full understanding of the drivers of the business case for equipping buses including the benefits to operators, local authorities and passengers that flow from investment in ticketing systems and real time information about vehicle location;

- The need, and possibly the requirement, for national standards for GPS systems similar to the standards that have been set for smartcard systems by ITSO;

- The collation of best practice from fleet-wide applications of smartcard and GPS systems that enables the full range of benefits to be extracted from public investment;

- The nature of agreements needed to deliver good quality and timely information to passengers, fleet managers, local authorities and regulators in a way that protects legitimate commercial interests, whilst ensuring that adequate summary information about service delivery is captured and that high standards of information delivery are incentivised;

- The ability of the industry to respond to speedy implementation of new solutions including the retro-fitting of vehicles currently in service. This may require significant increases in capacity for suppliers to undertake installation and a full understanding of the operational implications for bus services buses.

We would be interested to understand the basis of the business case DfT has developed for these options as some of the underlying assumptions may be different from those currently being used by some PTEs to promote investment in smartcards and RTI.

Finally, we are concerned that if investment in smartcards and RTI is favoured, use of BSOG may not be best approach. We have fundamental concerns about using an approach that rewards operators (with higher grant revenues) for past decisions by PTEs to grant fund the equipping of buses.

***Proposal 5: Payment of BSOG in Arrears and e-submission of claims***

*How should the transition be managed most effectively?*

*What level of automation of payments under a new IT system with e-submission of claims would be most appropriate?*

We feel this is primarily a matter for operators to discuss with DfT. The principle of mid-period on account payments is, however, one that most PTEs manage regarding concessionary travel, thereby balancing audit requirements with a schedule of payments that minimise cash-flow effects. Given that most bus operators will pay their fuel suppliers 'on account', we would hope that a system could be devised that both satisfies audit requirements and meets the legitimate concerns of operators. Furthermore, we would hope that with electronic service registrations becoming the norm, systems could be devised to ensure any major reductions in activity planned by operators could feed through into the BSOG system to minimise the risk of payment in advance by DfT.

DfT should recognise that if operators are disadvantaged by changes, operators will seek to mitigate these effects though fare rises and/or service de-registrations - with consequent adverse effect for passengers and/or local authorities. We therefore ask that PTEs be kept involved in the resolution of this issue.

**Proposal 6: Safe and Fuel Efficient Driving demonstration**

We fully support the principles of SAFED and would wish to see a high level of take-up by bus operators. The work done by SAFED in the past indicates that the bus and coach industry could save approximately £117million per annum in fuel costs, plus reductions in insurance and/or vehicle damage costs. Whilst fuel is likely to constitute a significantly smaller proportion of total costs in the bus industry, the significant growth in fuel costs may make it possible to achieve a similar level of commercial benefit. Having established the SAFED principles, we would have expected the key issue to be lack of awareness of the benefits of SAFED principles, rather financial incentives being required. It may therefore be that raising awareness with the possible introduction of tighter regulation of driver training may be the best way to proceed.

We would strongly question the need for funding to be withdrawn from BSOG to fund activity in this area.

**Other Alternative Options**

*Continue with the Current Approach,*

*Other options including: Tiered Rates of BSOG, Punctuality, Distance Based Payment, Direct Funding of Traveline*

***pteg*** is not yet convinced that any of the approaches proposed (other, possibly, than the proposals for paying London and QC areas separately) offers clear-cut advantages over the current system. We can see significant, in-principle merit in paying a higher level of the grant to encourage the introduction of LCBs. There are significant problems, however, in setting the incentive at the right level in an area with a fast-moving technology.

We agree that the other mechanisms considered by DfT should not be considered further, with one exception. The funding of Traveline is becoming increasingly fragmented, with some operators seeking to reduce their commitment to the organisation. We can see some merit in central funding for Traveline, in order to maintain its integrity as a single supplier of ‘mode neutral’ and objective information about public transport. However, there is no reason to link this issue with the reform of BSOG, and we would oppose ‘top-slicing’.

**Longer term options**

*Devolution of all subsidy to Local Authorities, including BSOG, irrespective of whether a quality contract is in place or not.*

*Moving to paying BSOG on a per passenger payment rate, or a passenger kilometre basis, instead of BSOG, once smartcards were in place, to support passenger numbers rather than subsidise fuel consumption.*

*Exploring more radical options for linking BSOG and concessionary fares reimbursement (for example, paying a much higher rate of BSOG – probably per passenger – and making it a condition of receiving this public subsidy that the operator carried concessionaires).*

The paper makes clear that much less consideration has been given to the longer term options than the 'numbered' proposals. As such it is even more difficult to present a definitive view of these options. We would wish to engage further in developing some of these ideas, depending upon the initial decisions made by the DfT. However, we would strongly urge DfT to take short-term decisions in the context of a long-term policy. It would make for poor policy making if long term considerations took us in a different direction from those made in the short term. In particular, it is vital that policy on concessionary travel reimbursement is viewed in conjunction with other forms of bus subsidy. We offer the following thoughts as a contribution to the debate:

- ***pteg*** sees some merit in fully devolving decisions about subsidy through a single body. In our view, the most appropriate body is the local transport authority. This potentially delivers efficient use of the grant and should lead to a close link between public policy delivery and application of funding. This may be the best way to drive effective use of subsidy payments;

- We think it unlikely that at a single date in the future local government will be ready to agree to the devolution of BSOG. We think it more likely that some authorities would want to pilot this approach ahead of others. We can also see a case for a transition, with dual sourcing of the subsidy over a period to minimise unintentional impacts from a sudden change. However, it may be that some local authorities would wish to retain the status quo indefinitely. Much would depend on long-term assurances about the quantum of grant. We would welcome further discussion on this option;

- Those authorities who choose to use 'strong partnership' approaches rather than a quality contract should not be disadvantaged. Within such frameworks, the local application of public funding may deliver better solutions that maximise value for money and lead to growth in patronage;

- More radical approaches to payment mechanisms may lead to unintentional consequences and introduce unwelcome distortions. For example peak passenger journeys are of greater 'value' than off-peak journeys, as there are likely to give greater external benefits through de-congestion. Payment per passenger may encourage operators to split routes to maximise incomes;

- We understand that CfIT is currently considering the practicability of introducing 'per passenger' payments. We look forward to responding to its deliberations, but are concerned that its work considers properly the full implications of a change as well as the practical issues of putting a new system in place. Clearly this method will need to take into account the issues involved in achieving full take-up of on-vehicle smartcard systems, and full conversion of current time-based ticketing to smartcard applications.

The paper raises the possibility of reforming funding for concessionary travel alongside changes to BSOG. We have not tackled this issue within this response, as we understand that a separate consultation on concessionary travel (CT) reimbursement and funding will be undertaken at a future date. We welcome the fact that other aspects of bus support are being considered alongside the changes to BSOG, but would want to reserve our position on possible links with CT until the options for future funding of this important service have been more clearly articulated.