Local Government Association

Projections of Expenditure on Bus Concessionary Travel by English Travel Concession Authorities

October 2009

INTRODUCTION

This Note summarises projections of expenditure on concessionary travel in England from 2008-09 to 2013-14. These are contrasted with assumptions about how funding to local authorities from central Government might change over this period.

It draws on a model which projects published data on bus concessionary travel volumes and expenditure, based on forecasting assumptions about demographic change, changes in commercial bus fares, bus operating costs, and (potentially) other factors.

BACKGROUND

Most, but not all, expenditure on concessionary travel by local authorities is associated with the delivery of mandatory travel concessions, which central Government has pledged to be fully funded by grant under the 'new burdens' principle.

With current legislation and administrative arrangements, the amount of money that local Travel Concession Authorities (TCAs) must spend on reimbursing bus operators is largely outside their control. In contrast, the funding that authorities receive from central Government, in the form of formula-funding together with special grant, is fixed in cash terms for 2009-10 and 2010-11. Given current pressures on public spending, it is also likely to be heavily constrained thereafter. Relatively modest growth in reimbursement could therefore easily lead to a significant gap between spending and funding that would result in undesirable and unforeseen consequences.

The work reported here sets out projections of reimbursement expenditure. There are uncertainties about the starting position for such projections, in addition to the uncertainties inevitably associated with projecting five years in to the future. The approach taken here is therefore high-level and indicative, with an emphasis on transparency of assumptions. In particular, the projections are 'policy neutral'. They assume that those who qualify for the concession, the services on which they may travel and the guidance used by (TCAs) to calculate reimbursement all remain unchanged.

EXPENDITURE

There are severe lags in the reporting of financial information regarding expenditure, and in the publication of data on critical influences such as concessionary passenger journeys and fare levels. The starting position is that bus reimbursement

expenditure in England in 2008-9 is assumed to be about £943m. This is based upon the most recent published data on concessionary travel expenditure on bus reimbursement, updated from 2006-7[1]. However, the assumed absolute quantum of expenditure in 2008-9 is not critical to the projections of percentage change which lead to this Note's conclusions.

Most of this expenditure is associated with older and disabled travel, which is assumed to change in line with the following key drivers:

- Demographic change. Office for National Statistics population projections are that the population in England aged 60 or over will grow by 8% from 2008-09 to 2013-14. It is assumed that concessionary trips will grow at the same rate.
- Changes in commercial fares. Under "no better off, no worse off" principles, increases in fares lead to increases in reimbursement expenditure. The projections mimic the application of DfT guidance to determining the influence of fares on reimbursement.
- Changes in bus operating costs. This affects the additional cost element of reimbursement.
- Exogenous trends. Although the spreadsheet model allows alternative assumptions to be made about underlying trends, the projections summarised here assume that such factors are neutral, i.e. that there is no underlying trend or residual growth.

Some of the expenditure included under "bus reimbursement" will not to be associated with older and disabled bus travel (e.g. child concessions, administration), although there is no data readily available to quantify this amount. The projections include reasonable assumptions about fares and costs, which are then subject to sensitivity testing to identify the impact of alternative future estimates of these variables.

FUNDING

It is not possible to verify the extent to which the "statutory" bus reimbursement expenditure by TCAs is fully funded in 2008-9 by central Government. However, there is little doubt that growth in the combination of formula funding and special grant, through which Government provides funds for the statutory concession, will be severely constrained in future:

[1] 2006-7 Expenditure taken from Public Transport Statistics Supplement 2007, updated to 2007-8 by growth in reimbursement expenditure from TCA returns to Central Government, and to 2008-9 by assuming an increase in expenditure associated with the change from a local to a national concession of £150m.

- In 2009-10 and 2010-11 the amounts of money to be distributed through special grant and formula funding is already known, and is specified in current prices;
- Between 2010-11 and 2013-14 HM Treasury's 2009 Budget Report gives an assumption that growth in revenue spend across Government between will average 0.7% pa in real terms.

Consequently the approach that we have adopted is to contrast how projected growth in expenditure compares with probable growth in funding. If current expenditure is fully funded in 2008-9, for example, the projections show to what extent growth in TCA expenditure commitments will continue to be adequately funded in the future.

PROJECTIONS

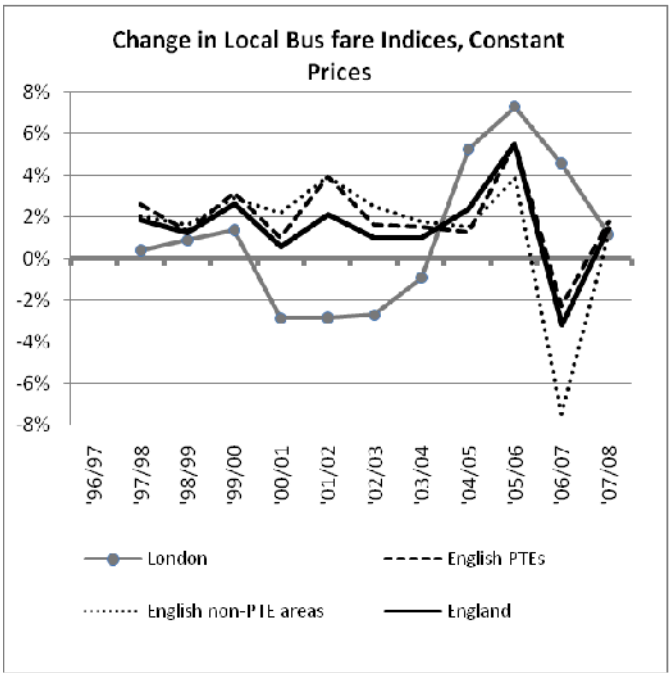
Illustrations of projections from the model are summarised below. It is necessary to make assumptions about inflation, which are based on those set out in the 2009 Budget Report. These are that RPI in 2009-10 falls by 1.25%, rises to 2.5% in 2010-11, 4.0% in 2011-12. Thereafter, we assume it stays at 2.5% p.a.[2].

Demographic change only

The most benign scenario with regard to public expenditure is that the only significant change in underlying influences on reimbursement arises from demographic change, as the older population increases. This leads to growth in expenditure in real terms from the estimated base figure of £943 million in 2008-09 to £1,152 million in 2013-14 (£1,012 million in 2008-9 prices). Annual increases in expenditure in real terms vary from 1.6% p.a. in 2009-10, to 1.3% p.a. in 2013-14. Changes in the size of the elderly population are relatively predictable and have been assumed to have the same impacts in the other scenarios discussed below.

Increases in fares

A situation in which only demographic change affects reimbursement expenditure is extremely optimistic, given historic trends in bus fares and operating costs. Outside London, in most years over the last decade, bus fares have consistently increased at a faster rate than inflation, as illustrated in the chart.



Transport Statistics Bulletin GB 2008 reports that the local bus fare index for England increased by 1.5% on average in real terms between 1996-97 and 2007-08. However, this overall rate of growth disguises the influence of significant policy variables in the form of low fares in London, and the impact of mandatory free travel in April 2006. Since the index is based on average revenue per passenger (including concessionary passengers), it will not fully reflect changes in adult commercial fare levels outside London.

[2] The Budget Report specifies its RPI forecast as the per cent change, in Q4 of the calendar year. For simplicity it has been assumed that these can be taken as averages for the relevant fiscal year.

Expenditure projections based on this historic data on changes in fare levels are likely to be significantly understated.

Even so, if it is assumed that commercial fares increase by an average of only 1.5% per year in real terms over the forecast period, then expenditure on bus reimbursement is projected to grow to £1,074 million in 2008-9 prices, an increase of 13.5%. This projection, and others, are based on the application of current DfT Guidance on Reimbursement, starting with an elasticity value in 2008-9 calculated to replicate the assumed total expenditure on bus reimbursement in that year.

Increases in costs

Evidence of trends in operating costs is more erratic than that for fares. Indices of operating costs per vehicle kilometre published by DfT show an average change per year in real terms of 3.1% between 1997-98 and 2006-07, while the index of costs per passenger journey changes by 1.4% per year over the same period. However, there are significant variations from year to year, likely to have resulted from sampling fluctuations associated with the operator returns used. For illustration, the projections below have assumed a modest 1.5% increase in operating costs per year in real terms. This is consistent with an assumed 1.5% growth in commercial fare levels, though this implicitly assumes no patronage growth or decline.

With "no better off, no worse off" reimbursement, the direct influence of changes in operating costs on reimbursement is limited to compensation of operators for generated passengers. If both operating costs and commercial fares increase by 1.5% per year in real terms, growth in expenditure by 2013-14 is 14% in real terms, £4 million higher than in a scenario under which only fares increase in real terms.

Other scenarios

In our view, a scenario such as this, under which both fares and operating costs rise in real terms, is much more probable than an assumption under which both fares and costs simply keep pace with inflation. Reimbursement expenditure is highly sensitive to commercial fare levels. In fact, fare increases significantly greater than 1.5% per year in real terms are consistent with the evidence of much of the last decade for most of England, and is certainly the anecdotal experience of many Travel Concession Authorities.

Our projections show that if commercial fares increase by 3% per year (keeping operating cost rises at 1.5% per year in real terms), expenditure on bus reimbursement would rise by 20% in real terms by 2013-14, an increase of 34% in current prices. This seems likely to be the most realistic of the scenarios that we have examined, given historic experience.

It should be emphasised that the figures quoted here assume that there is no underlying trend in the volume of concessionary passenger journeys relative to the estimated 2008-9 level. It is possible that once the National free travel scheme has

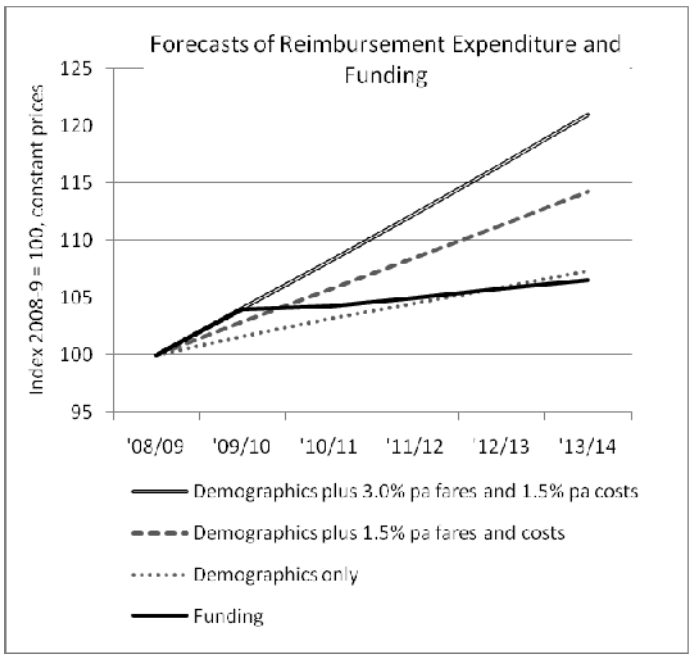
become established, the underlying decline in concessionary travel, evident in some areas before free travel was introduced, will resume. On the other hand, some factors contributing to that decline are likely to have changed, and the free travel scheme itself will have created a changed dynamic with regard to bus use. Consequently, the zero trend assumption adopted here is regarded as being neutral, although the uncertainties associated with long term trends need to be acknowledged.

The projections for the different scenarios are summarised in the table below.

Total Expenditure (£m, 2008/09 prices)	**'08/09**	**'09/10**	**'10/11**	**'11/12**	**'12/13**	**'13/14**	**Increase '08-9 to '13-14**
Demographic change only	*£943*	£958	£973	£986	£999	£1,012	7.3%
(increase per year)		*1.6%*	*1.5%*	*1.4%*	*1.3%*	*1.3%*	
… plus 1.5% p.a. increase in fares	*£943*	£970	£996	£1,021	£1,047	£1,074	13.5%
(increase per year)		*2.9%*	*2.7%*	*2.6%*	*2.5%*	*2.5%*	
1.5% p.a. increase in fares, and 1.5% pa in costs	*£943*	£971	£997	£1,023	£1,050	£1,078	14.0%
(increase per year)		*2.9%*	*2.7%*	*2.6%*	*2.6%*	*2.6%*	
Demographic change, plus 3% p.a. increase in fares, and 1.5% p.a. increase in costs	*£943*	£982	£1,020	£1,059	£1,100	£1,141	20.3%
(increase per year)		*4.1%*	*3.9%*	*3.8%*	*3.8%*	*3.8%*	

It should be noted that various technical assumptions are required in order to make these projections. In particular, it is necessary to make assumptions about average fare values and marginal cost per generated passenger in 2008/09, the starting year. However, the outcomes appear to be relatively insensitive to alternative values of these starting assumptions.

Changes in funding relative to increases in expenditure



The projected year-on-year increases in expenditure can be contrasted with the potential for growth in funding.

Growth in formula funding and special grant in 2009/10 and 2010/11 is known with reasonable certainty, in cash (current price) terms. Funding in later years is more speculative, but HM Treasury assumptions set out in the 2009 Budget Report indicate that spending growth across the public sector will be no more than 0.7% in real terms. We assume here that this is the basis on which local authority grant funding changes from 20011/12.

These assumptions lead to the potential trajectories of expenditure and funding shown in the chart.

The chart shows expenditure and funding, measured in real (constant price) terms, represented by an index set to a value of 100 in 2008-9. It demonstrates that only under the most optimistic of scenarios is it likely that increases in funding will keep pace with probable increases in expenditure on bus reimbursement.

Increases in fares and operating costs of 1.5% per year in real terms would lead to growth in expenditure outpacing growth in funding by 7.8% of its 2008-9 level in real terms, and fare increases of the order of 3% per year would result in expenditure by 2013-14 that had risen by 14.5% more than funding in real terms.

As noted above, none of these projections allow for underlying trends in the volume of concessionary travel. If concessionary boardings continue to grow in 2009-10 and beyond, it will drive reimbursement expenditure even higher, and add to potential funding problems.

SENSITIVITIES

A number of assumptions have had to be made in order to develop these projections, additional to those related to the scenarios themselves. Expenditure projections are influenced by the detailed way in which reimbursement is related to passenger journeys and fares, which attempts to simulate the operation of DfT recommended reimbursement methodology. To apply these calculations, it is necessary to assume how "bus reimbursement expenditure" in 2008-09 is divided between expenditure that can be related to older and disabled concessionary journeys, and "other" expenditure - primarily child concessions and administration.

The projections quoted above assume that of the projected 2008-9 total expenditure of £943 million, £50 million falls into this "other" category, which then stays constant in real terms (although other assumptions could be adopted). If alternative amounts are assumed, then total expenditure projected over the five years also varies. Broadly, the smaller the amount assumed, the larger the influences of older and disabled trips on total reimbursement, leading to projections of larger funding deficits. Thus, under a scenario of 1.5% growth in fares and costs, projected growth in expenditure in 2013-14 in real terms from 2008-9 would vary from 13.2% and 14.8% if "other" expenditure is assumed to be either £100 million or zero. The latter assumption is equivalent to assuming that all the expenditure classified as "Bus Reimbursement" by DfT is directly proportional to "no better, no worse off" reimbursement for older and disabled concessionary journeys.

The reimbursement calculations require an average commercial fare level in 2008-09 to be assumed. The projections above are based on an assumed average figure of £1.514 across the whole of England. This has been estimated from a combination of DfT average revenue per passenger data (from 2006-07), adjusted by PTE data giving an estimate of the relationship between this figure and the typical adult

commercial fare used for reimbursement. However, varying this value between £1.00 and £2.00 changes the forecast increase in expenditure to 20013-14 by less than 1% from the central estimate (e.g 14.8% to 13.4%). The sensitivity of projections to changes in the marginal additional cost assumption (set at 9.4 pence per generated passenger in 2008-09) is even less.

However, the lack of sensitivity of outcomes to the assumed starting level of commercial fares in 2008-9 does not reduce the significance of changes in the commercial fare to outturn expenditure. Many TCAs have seen the average fares used for concessionary reimbursement in recent years rise significantly more than the range represented in our scenarios. There is no certainty that average fare rises will keep within this range, which our projections demonstrate have a very significant impact on reimbursement payments. Indeed, if bus companies continue to see a decline in fare-paying passengers, then it is quite likely that real increases in fares will outpace the assumptions illustrated in these scenarios.

CONCLUSIONS

Projections of changes in reimbursement expenditure have been constructed that reflect demographic growth and alternative scenarios of increases in bus fares and costs. These show that if fares and costs keep pace with inflation and no more, then expenditure on bus reimbursement will rise by 7% in real terms by 2013-14 relative to 2008-09, which will broadly match Budget assumptions of funding growth.

However, on the basis of historic trends, it is highly likely that rises in fares and costs will outpace inflation. This will lead to substantially greater growth in expenditure on reimbursement by TCAs, if they adhere to current reimbursement principles. Increases in fares and costs by only 1.5% p.a. in real terms, which represents an optimistic reading of the experience of the last decade, would lead to increases in expenditure by 2013-14 of 14%. If commercial fares increase by 3% per year in real terms, there would be a 20% real growth in reimbursement expenditure. In contrast, the current grant settlement and the 2009 Budget Report indicates that relevant public funding will only rise by 6.5% in real terms between 2008-9 and 2013-14.

The projections illustrate two key issues:

- that growth in funding support for concessionary travel reimbursement appears unlikely to keep pace with the growth in expenditure that will be incurred by TCAs in satisfying their statutory obligations;
- the major uncertainties about growth in expenditure, which cannot be controlled by TCAs because of the open-ended nature of "no better off, no worse off" reimbursement. The most significant uncertainties arise from changes in future commercial fare levels, which outside London are decided soley by bus companies without reference to TCAs.

Uncertainties and variations in growth in expenditure will be most apparent at a local level. The experience of the last few years is of a toxic combination of local

circumstances, combining to create disproportionate impacts on individual TCAs, leading to a variety of undesirable and disruptive unforeseen consequences. Changes in the structure of government funding for local authorities over the years, including the transition from Revenue Support to Formula Grant, make it impossible to judge the current adequacy of funding for concessionary travel. What is adequate at the national level may be far from adequate at an individual authority level, particularly when the fares policies of individual bus companies are taken into account.

As demonstrated by the difficulties of some local authorities following the distribution of special grant, allocations of overall funding must satisfy requirements at the local as well as the national level, if unintended local consequences are to be avoided. Moreover, the dangers of unintended consequences will be much greater if the assumptions about future government funding, on which our projections are based, prove too optimistic.

If the next Spending Review is deferred until after the forthcoming General Election, a clear indication of overall revenue expenditure is unlikely until well into 2010. However, a downward revision in public spending seems much more probable than an upward one. If this is what happens, and assuming that concessionary travel is appropriately funded at present, Government grants relating to this service will need to take an increasing share of public spending if Government is to keep its commitment of fully funding 'new burdens'.

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