Consultation Response

Local Government Finance Formula Grant Distribution Consultation Paper

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1. Introduction

1.1. ***pteg*** represents the six English Passenger Transport Executives (PTEs) in England which between them serve more than eleven million people in Tyne and Wear, West Yorkshire, South Yorkshire, Greater Manchester, Merseyside and the West Midlands. Leicester City Council, Nottingham City Council, Transport for London (TfL) and Strathclyde Partnership for Transport (SPT) are associate members of ***pteg***, though this response does not represent their views. The PTEs plan, procure, provide and promote public transport in some of Britain's largest city regions.

1.2. One of the PTEs' key responsibilities is to administer the English National Concessionary Travel Scheme (NCTS), which currently represents over one third of the PTEs total revenue expenditure and is funded through a combination of Special Grant from DfT and levies from districts. Although PTEs do not receive Formula Grant directly from CLG, they need to recoup the cost of administering the scheme from constituent districts. We therefore have a keen interest in CLG's proposed changes to the concessionary travel element of the EPCS block of local government Formula Grant and welcome the opportunity to respond to the present consultation paper.

1.3. One important point that we feel must be made from the outset is that CLG's exemplifications have highlighted the inadquacies of the Formula Funding process in appropriately compensating transport authorities for administering the statutory NCTS and that there is therefore a clear on-going need for the continuation of a parallel system mediated by DfT (currently Special Grant). As a matter of principle, we would question the idea of funding a national statutory scheme beyond the influence of local authority powers through the Formula Grant.

2. *pteg* response

2.1. Our response is limited to the the Concessionary Travel sub-block element of chapter 12 (Transfers and Adjustments) and the question on floor damping levels in chapter 11. With regard to chapter 12 we are asked to comment on our preferred approaches for:

- reducing current Formula Funding payments to districts;
- re-allocating available Formula Funding back to upper-tier authorities.
- allocating available Special Grant to upper-tier authorities on a formula basis.

Chapter 12 – Transfers and Adjustments

Question 18: Which of the four options for removing concessionary travel from lower-tier authorities do you prefer (CONCF1, CONCF2, CONCF3, CONCF4)?

2.2. Our preferred option is CONCF3. The rationale for this choice is explained below.

2.3. On technical grounds we can see obvious merit in reducing funding by the same amount pro-rata that it was increased by in 2005-6 (i.e.: CONCF3 and CONCF4) rather than by 2010-11 net revenue expenditure (i.e.: CONCF1 and CONCF2). This is based on the understanding that this part of the consultation document is about the Formula used for allocating CLG funds. Hence it would make no sense, in our view, if expenditure, rather than the amount effectively calculated through the formula at present, was to be used as the basis on which to reduce grant payments to districts.

2.4. Using the approach suggested by CONCF1 and CONCF2 would effectively mean that, where net revenue expenditure on CT currently exceeds that calculated in the Formula, the government would be taking money away from districts that it had not actually given out in the first place. One the other hand, where net revenue expenditure on CT is currently below that paid through the formula this implies that districts are using part of the concessionary sub-block for other purposes. Removing only the net revenue expenditure would, in those cases, give districts an unjustified windfall and remove the control total amount available to be re-allocated to districts as a whole as part of the concessionary travel sub-block.

2.5. With respect to the choice between CONCF3 and CONCF4, our view is that the first of these options would possibly better reflect the current level of need in terms of CT reimbursement to operators as it relies on more recent data. We expect that it would therefore minimise the amount of upheaval caused by changes to the formula.

Question 19: Which of the options for rolling in concessionary travel to upper-tier authorities do you prefer?

2.6. We can see merit in either:

- CONCF8 and CONCF30 (should CONCF3 be chosen as the option for reducing funding to districts); or in
- CONCF14 and CONCF34 (should CONCF4 be chosens as the option for reducing funding to districts).

2.7. The rationale for these choices is explained below.

Re-allocating Formula Funding to districts

2.8. The CLG consultation document has exemplified 5 alternative regressions as the basis on which to re-allocate funding to districts, which we refer to as equations 1 to 5, as follows:

1. District Weight (based on regressions against past expenditure) = 1.3006 + 17.5151*Income Support/Income Based Jobseekers's Allowance/Guarantee Element of Pension Credit Claimants – 3.3142*Wealthy Achievers + 3.1365*Sick and Disabled People in Households with no car or van
2. District Weight (based on regressions against past expenditure) = 1.4533 – 2.5719*Population Sparsity for people aged 60 and over +17.1294*Incapacity Benefit and Severe Disablement Allowance + 5.1353*People aged 60 and over with no car or van
3. District Weight (based on regressions against concessionary trip estimates on all modes) = 22.8808*Country of birth of residents – 3.6705*Wealthy Achievers + 6.8381*Sick and Disabled People in Households with no car or van
4. District Weight (based on regressions against past expenditure) = 1.1058-1.6589* Population Sparsity for people aged 60 and over +17.1294*Incapacity Benefit and Severe Disablement Allowance + 19.6238* Income Support/Income Based Jobseekers's Allowance/Guarantee Element of Pension Credit Claimants + 0.4213*Estimated bus journeys per head
5. District Weight (based on regressions against concessionary trip estimates on all modes) = 0.2907*Population density - 3.5470*Wealthy achievers + 1.0502 * Estimated bus journeys per head

2.9. CONCF8 and CONCF14 re-allocate funding to districts on the basis of regression 2. CONCF30 and CONCF34 re-allocate funding to districts on the basis of regression 4.

2.10. Our main reason for supporting regression 2 is that it is the only option to include both elderly and disabled population as explanatory variables, which, taken at face value, are likely to be the main drivers of concessionary travel demand. Data from the metropolitan areas shows that disabled passholders represent only 10-15% of all passholders entitled to use the statutory scheme. Disabled passholders have also been found to have lower trip rates than elderly passholders. Using a measure of disabled population but not elderly population (as is the case for regressions 1, 3 and 4) therefore fails to take into account the key driver of CT demand.

2.11. On the other hand, regression 4 includes the explanatory variable "bus journeys per head". While this variable reflects trip rates by all passengers, it is likely to be closely correlated with trips made by concessionary passengers. This variable can therefore be interpreted as a suitable replacement for elderly population.

2.12. Both regressions 2 and 4 include a negative correlation between reimbursement and population sparsity[1], which we see as reflecting the increased opportunity to travel in denser areas which are able to support more comprehensive and higher frequency bus networks. There is a well-known strong and positive relationship between service levels and demand[2], which we feel this variable partly takes into account. The difference between regressions 2 and 4 is that population sparsity is given a lower weight, possibly to reflect the inclusion of the variable bus trips per head. The latter variable partly reflects service levels and hence population sparsity/density.

2.13. Looking at the other alternatives we would strongly oppose the use of regressions 1 and 3 as they fail to take into account in any way either service levels, trip rates or a measure of elderly population, possibly the most obvious drivers of demand. We particularly fail to see any merit in regression 3 as it seems to put a huge weight on country of birth of residents, which, in our view, is unlikely to have any impact on bus usage. Although regression 3 does seem to have the highest adjusted R^2 , we would argue this is due to the high correlation between foreign population and concessionary travel expenditure in London. We would argue that, in effect, the relationship between these two variables is purely spurious and is unlikely to represent a sound basis on which to allocate grant funding in the future.

2.14. Regression 5 does take into account bus trips per head and population density. The other variable is relies on "wealthy achievers" is, however, unlikely to be a key determinant of CT demand. We could see some merit in the use of related variables such as income support (since car ownership is much lower and bus usage much higher amongst the lowest income groups[3]), but there is little reason why the proportion of wealthy achievers should be correlated with the proportion of population in the lowest income groups.

2.15. But, in our view, the main shortcoming of regression 5 is the fact that it establishes a relationship between these explanatory variables and bus trip rates rather than

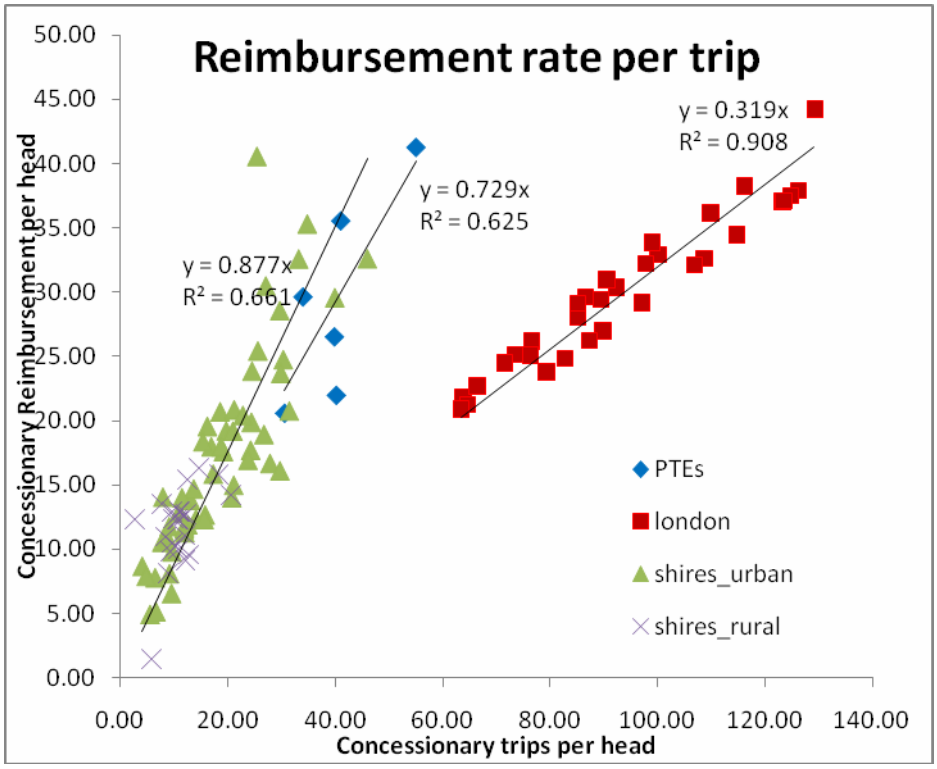
[1] Which we assume is the inverse of population density

[2] TRL, 2004 estimates an elasticity of 0.66 between bus demand and service frequency.

[3] DfT (2008), "Regional Transport Statistics", available from: http://www.dft.gov.uk/pgr/statistics/datatablespublications/regionaldata/rtslivetables

concessionary travel expenditure. Figure 1 shows that bus trips per head are actually a relatively poor proxy for CT expenditure. This is because the reimbursement rate per passenger is much lower in London than elsewhere, which could be related to systematic differences in trip length distributions, bus industry cost structures and average fares. So while the strong correlation between concessionary trips and bus trips per head demonstrated by regression 5 is potentially very sensible, the use of CT trips as a single proxy for CT expenditure is not. A further concern with regression 5 is that it fails to take into account any measure of disabled population.

Figure 1. Reimbursement rate per trip



Source: PTEG analysis based on CLG data provided to Settlement Working Group

Re-allocating Special Grant to districts

2.16. CLG have put forward two options for re-allocating Special Grant as part of the Formula Funding process:

- Proportionally to current Special Grant allocations
- Based on the new Concessionary Travel formula (i.e.: using equations 1-5 described above).

2.17. Our view is that current Special Grant allocations are a means to correct for the shortcomings of the current formula. Assuming that the formula will change significantly following this consultation in order to more accurately reflect the cost of reimbursing operators for the statutory scheme there would be little reason to use past Special Grant allocations as the basis on which to re-allocate Special Grant to districts. Under this assumption we would therefore support the second option, which is implicit in CONCF 8/14/30/34.

The fundamental need for an alternative to Formula Funding

2.18. However, we would argue that if CLG's exemplifications have demonstrated one thing it is the fact that the Formula Funding process does not appropriately compensate districts for administering the statutory CT scheme and that there is a clear on-going need for the continuation of a parallel system mediated by DfT (currently Special Grant). In fact we would question the whole principle of funding a national statutory scheme beyond the influence of local authority powers through the Formula Funding process.

2.19. Figure 2 shows the relationship between the estimated level of Formula Funding[4] and our own estimates of the appropriate level of reimbursement based on concessionary trip numbers and assumptions about the reimbursement rate per trip by district type[5]. What this graph clearly highlights is that Formula Funding provides an adequate level of reimbursement only for a very small minority of local authorities. As a result there will be huge winners and losers from this process. But while the winners will keep quiet the losers will quite rightly demand proper compensation from government. This will inevitably put further pressure on government finances as the statutory concessionary travel scheme is a matter of national, rather than local, policy. Hiding these inequities behind the Formula Funding process will not solve the likely funding shortfall.

2.20. The reason for the discrepancy between Formula Funding and our estimate of the adequate level of reimbursement is that CLG rules only allow certain types of variable to be used in the Formula. The problem is that none of the key variables which directly drive reimbursement (most critically, the number of concessionary trips effectively made) can be used as an explanatory variable in the Formula. The other key variables driving reimbursement are average discounted fare levels and bus industry operating costs. While bus operating costs do not seem to vary significantly across the country[6] average fares do. This is because average fares are a function of trip length distributions, level of demand, price of competing modes, bus operator pricing strategies, service quality amongst other factors. The publication of the DfT's draft Reimbursement Guidance has served to highlight the severe dangers that could arise from the Formula Funding scattergun approach to the concessionary travel sub-block.

2.21. These dangers are particularly high in metropolitan areas where concessionary travel now represents over one third of PTE revenue budgets.

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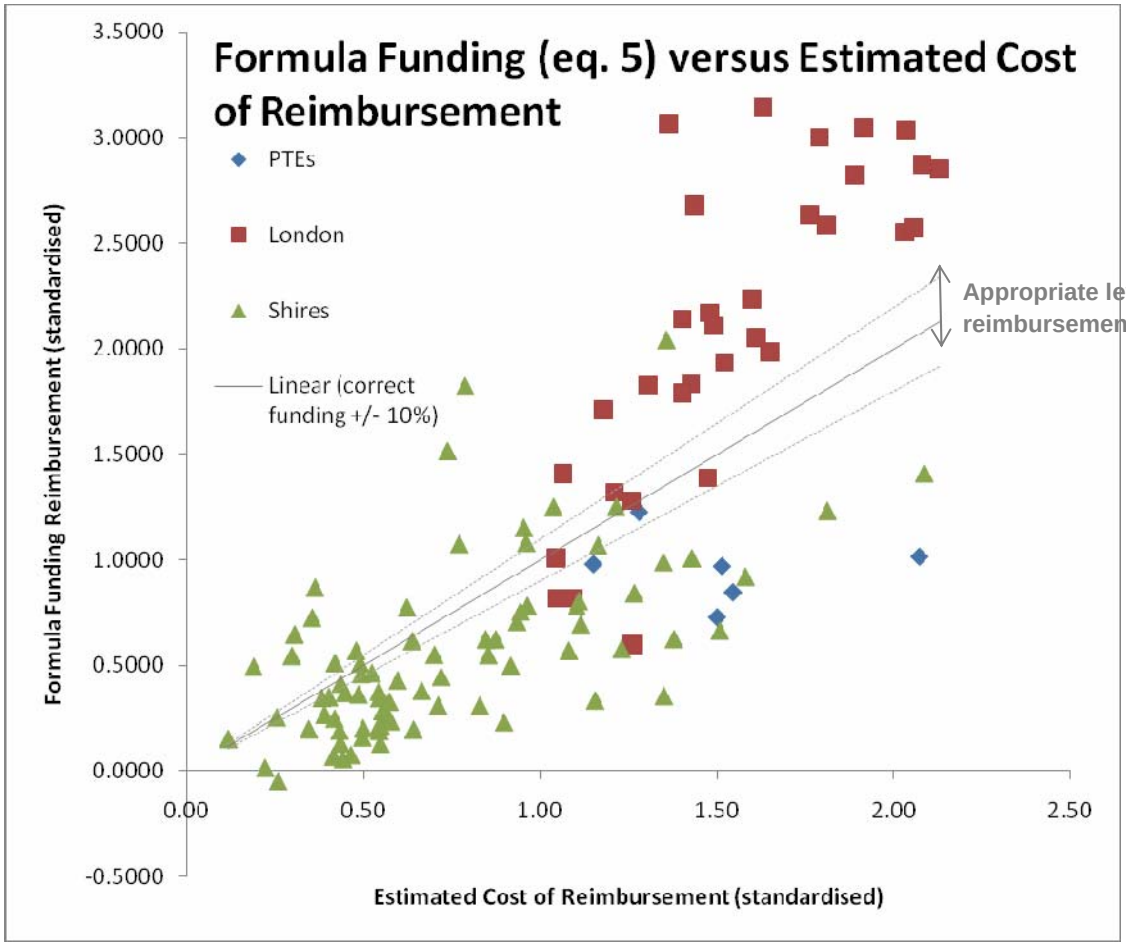
[4] Based on regression 5 for which detailed data is provided by CLG.

[5] Our estimate of the appropriate level of reimbursement is obtained by multiplying total concessionary trips by average reimbursement rates calculated for comparable districts (London, PTEs and Shires). Although this methodology is a gross simplification of the proposed DfT Reimbursement Guidance it does take into account the key drivers of reimbursement: trip making and cost per trip. Our analysis suggests that the draft Guidance would be likely to yield a level of reimbursement within +/- 10% of our central estimate. These upper and lower bounds are represented in the graph by the grey dotted lines above and below the central full line.

[6] http://www.dft.gov.uk/pgr/regional/buses/costs/

Figure 2. Formula Grant regression versus Estimated Cost of Reimbursement



Source: PTEG analysis based on CLG data provided to Settlement Working Group

Question 20: Should concessionary travel have its own sub-block?

2.22. Yes, we consider that improved transparency in the arrangements for funding concessionary travel is required. Having a separate sub-block would assist in providing this transparency. This is particularly critical in metropolitan areas where the Integrated Transport Authorities who are responsible for administering the ENCTS do not receive Formula Funding directly but instead need to collect funding from districts.

2.23. Furthermore, it is important to highlight that there are underlying cost drivers that are likely to increase spending in this area over time (see annexed LGA paper). There should therefore be an explicit arrangement that helps ensure that government funding rises in line with the way these external drivers change the cost of delivering national policy. Having a separate sub-block would contribute towards this objective.

2.24. These issues again highlight the need for an alternative to the Formula Funding process for correctly and directly reimbursing those bodies administering the scheme (as is presently the case with Special Grant).

Other Comments

2.25. We would question the exemplifications put forward in the consultation paper as regards the quantum of funding used. In our view, the figure used (based on net revenue expenditure

rather than the amount of funding which has been put into the system since 2001) fails to reflect the total amount of grant that has been provided over the past few years to cover the cost of concessionary travel reimbursement. We would argue that the fact that net revenue expenditure is below the current level of funding is a product of the inequities of the Formula Funding process (as illustrated in figure 2 above) rather than proof of the adequacy of the overall funding level. Given the statutory nature of this scheme the rationale for determining the quantum of funding needs to be based on the cost of providing the scheme. At present, the DfT draft Reimbursement Guidance seems to be the most appropriate way for dealing with this.

2.26. We continue to be very concerned about the Government's proposal not to extend the period over which the current Special Grant arrangements are in place. The DfT proposes major changes in the reimbursement arrangements, and we fear the unintended consequences of structural changes in the funding regime at the same time. We consider that there are significant benefits to be had in maintaining Special Grant for all types of authorities, with the formulae currently being used being reworked on the basis of the new set of TCAs. This is particularly the case with ITAs where there is real merit in paying grant to the authority with direct responsibility for service delivery, rather than channelling the grant via District authorities, which inevitably creates winners and losers though the operation of the levying system.

Chapter 11 – Floor Damping Levels

Question 17: Over the next Spending Review period do you think that the floor level should be set close to the average change or such that it allows some formula change to come through for authorities above the floor?

2.27. Should there be a substantial cut in concessionary travel grant, we can see the value in the floor being set close to the average level of cuts envisaged. We recognise that this could almost entirely negate the impact of formula change in the short term, but consider this to be the appropriate response by allowing districts time to adapt to longer term changes in funding.