Title: Reforming bus subsidy in England **IA No: DfT00159** **Lead department or agency:** Department for Transport **Other departments or agencies:**	**Impact Assessment (IA)** **Date:** 01/07/13 **Stage: Final** **Source of intervention:** Domestic **Type of measure:** Secondary legislation **Contact for enquiries**: Tim Barrow buses@dft.gsi.gov.uk
	RPC: RPC Opinion Status

Summary: Intervention and Options

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
Unknown	Unknown	Unknown	No	Not applicable

What is the problem under consideration? Why is government intervention necessary?

Bus Service Operators Grant (BSOG) is the main bus subsidy funded by DfT. The aim in supporting buses is to lower congestion, increase accessibility and reduce social exclusion. We have reviewed BSOG to better target funding on DfT's objectives, notably tackling congestion. BSOG is linked to fuel consumption so bus operators receive more subsidy if they increase consumption; this suggests the subsidy is poorly linked to environmental objectives. In reforming BSOG, DfT will create better incentives for local authorities and operators to work together, provide better services for passengers and deliver better environmental outcomes and value for money.

What are the policy objectives and the intended effects?

The policy objectives of the proposed changes to bus subsidy are: to encourage bus patronage growth in order to reduce congestion and pollution levels, to incentivise bus operators to deliver improvements in their fuel efficiency and to invest in more fuel efficient buses and to improve bus services for passengers. The proposed policy reforms impact in different ways and no single measure will simultaneously deliver all of these objectives. However, the objective is to ensure an improvement in the overall value for money of bus subsidy.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The main policy options include: no change in the current BSOG system i.e. ‘do nothing’ (Policy Option 1), selective devolution of bus subsidy to local authorities (Policy Option 2) and devolution of all BSOG funding to authorities (Policy Option 3). The Government is now implementing Option 2. This provides the best balance between giving local authorities, and so local people, more influence over how bus services can be designed to meet the transport needs of their individual areas, without introducing wholesale untested changes to the subsidy regime at a time when economic conditions mean the bus market is relatively fragile.

A consultation on the proposals was carried out between 13 September and 12 November 2012.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** As part of a further review of the BSOG system to be carried out in 2014.

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** n/a	**Non-traded:** Unknown	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister ……Norman Baker ……………..……………………………………Date……01/07/2013…

Summary: Analysis & Evidence

Policy Option 2

Description: Devolution of BSOG funding for certain services to Local Authorities

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optimal	**High:** Optimal	**Best Estimate:** Optimal

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low			£ Xm	**£Am**
High			£Ym	**£Bm**
Best Estimate			£ Zm	**£Cm**

Description and scale of key monetised costs by 'main affected groups'

This option comprises the devolving of all BSOG for supported bus services to local authorities outside London, devolving all BSOG funding in London and the gradual devolution of both supported and commercial services to a small number of lead local transport authorities outside London who successfully compete to be a 'Better Bus Area' (BBA).

As this measure is predominantly about the devolution of bus subsidy, many impacts cannot be monetised given it depends on how the devolved resource is used. The devolution of BSOG to local authorities and the Greater London Authority / Transport for London is a simple transfer from central government.

In Better Bus Areas, the DfT will provide an additional level of 'top-up' subsidy which is to be calculated on the basis of a top-up rate of 20% of the devolved commercial BSOG in a designated BBA area. Given the BBA competition will be run over summer 2013, the exact cost of the top-up subsidy cannot be estimated at this stage. Here, we have assumed it to be £Zm per year and £Cm in present value terms. This is a cost to the public sector and will be provided to those local authorities who are awarded BBA status following a competitive process.

Other key non-monetised costs by 'main affected groups'

The devolution of BSOG for supported/franchised services outside of London and in London respectively is expected to have little impact on the bus operators as contract prices will change to reflect the fact that local authorities receive this payment rather than the operator. Gradually devolving BSOG for commercial services in BBAs replaces direct subsidy with an improved bus market. Just removing BSOG from bus operators would increase total costs by 6%, increasing commercial fares by approximately 4% and seeing commercial services contract by around 6%[1]. However, the plans for BBAs will be judged on their ability to promote economic growth by growing the bus market – negating these impacts. They will also be judged to ensure that they are, at worst, carbon neutral.

There is a short term administrative cost for services operated under contract as some operators will need to renegotiate contracts to take account of higher fuel costs. Funding which is devolved to local transport authorities will be available to cover these additional costs. There is also a cost to local authorities with BBA status and to the operators inside those BBAs of having to develop the bid for funding and estimate the split of commercial services that are in and outside of the designated BBA area and its associated BSOG

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low			2.1 x £Xm	**2.1 x £Am**
High			2.5 x £Ym	**2.5 x £Bm**
Best Estimate			2.3 x £Zm	**2.3 x £Cm**

[1] Analysis carried out using the department's National Bus Model (NBM)

Description and scale of key monetised benefits by 'main affected groups'

As this measure is predominantly about the devolution of bus subsidy, many impacts cannot be monetised. There is currently insufficient information available to quantify fully the benefits, given the level of subsidy is undecided. DfT will designate BBAs by competition and require them to offer high value for money – at least higher than BSOG. The BBA concept is being piloted in Sheffield where the BCR was estimated as 2.5 over a ten year period. These benefits are predominantly decongestion, wider consumer welfare benefits and additional commercial revenue to bus operators from the increase in demand.

Other key non-monetised benefits by 'main affected groups'

With regard to the devolution of BSOG itself, bus subsidy is diverted away from operators to local authorities and so there is a carbon benefit as bus operators in BBAs, London and those on 'supported' contracts have greater incentives to invest in low carbon buses, eco-driver training and conserve fuel. Figure 2 shows that detaching bus subsidy from fuel consumption, and therefore having bus operators incur the full cost of fuel, improves the business case for investing in low carbon emission buses (LCEB) by a further £30k per bus. LCEBs deliver at least 30% saving in greenhouse gas emissions compared to a similar sized standard diesel bus.

There may also increasingly be administrative savings to bus operators from no longer having to separately claim BSOG in respect of BBAs, services running under contract that do not claim incentives, and London bus operations.

In addition, the devolved funds together with the additional level of subsidy provided to local authorities in BBAs will mean that local authorities are able to increase the demand for bus travel by influencing directly the in-vehicle time of a bus trip through bus priority measures and by altering the cost of using different modes. This may result in decongestion benefits and wider consumer welfare benefits as was witnessed in the recent BBA competition. By only funding bids that are at least higher value for money than the current BSOG system, there will also be an improvement in welfare and an increase in bus patronage.

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5%

- The BBAs that are funded are all high value for money with a Benefit Cost Ratio of at least the local BSOG. If this is achieved, this policy should increase overall welfare. BCR of 2.5 is taken as the high scenario, based on Sheffield's pilot BBA assessment.
- The partnership arrangement put in place by the local authority ensures commercial fares do not increase or there are compensating measures introduced by the local authority and/or bus operators.
- There is a risk that by encouraging local authorities and bus operators to jointly bid to become a BBA, potential competition could be reduced. The intention is to design the BBA in a way that limits this and is inclusive of new entrants wanting to enter the market.
- Prices of contracts for supported services outside of London and for franchised contracts in London are negotiated to reflect the transfer of BSOG from operators local authorities and to TfL/GLA.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			**In scope of OITO?**	**Measure qualifies as**
Costs: Unknown	**Benefits:** Unknown	**Net:** Unknown	No	Not applicable

Summary: Analysis & Evidence

Policy Option 3

Description: Devolution of all BSOG to local authorities

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2010	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Unknown	**High:** Unknown	**Best Estimate:** Unknown

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Unknown		Unknown	**Unknown**
High	Unknown		Unknown	**Unknown**
Best Estimate	Unknown		Unknown	**Unknown**

Description and scale of key monetised costs by 'main affected groups'

This option would involve devolving all of the existing BSOG budget to local authorities – including all services outside of London which are run on a commercial basis. The impacts of this policy option are unknown given local authorities would be free to use the devolved resource as they see fit. The transfer of BSOG from bus operators to local authorities is a direct transfer.

Other key non-monetised costs by 'main affected groups'

In the absence of local authority action, bus operator total costs would increase by 6%, commercial fares would increase by approximately 4% and commercial services contract by around 6%. Whilst many local authorities would take action to mitigate these impacts, some are likely not to be in a position where they can afford to do so effectively.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Unknown		Unknown	**Unknown**
High	Unknown		Unknown	**Unknown**
Best Estimate	Unknown		Unknown	**Unknown**

Description and scale of key monetised benefits by 'main affected groups'

The impacts of this policy option are unknown given local authorities would be free to use the devolved resource as they see fit.

Other key non-monetised benefits by 'main affected groups'

As bus subsidy is diverted away from operators to local authorities, there is a carbon benefit as **all** bus operators have greater incentives to invest in low carbon buses, eco-driver training and conserve fuel. This means the carbon benefits are greater than under Policy Option 2. Figure 2 shows that detaching bus subsidy from fuel consumption, and therefore having bus operators incur the full cost of fuel, improves the business case for investing in low carbon emission buses (LCEB) by a further £30k per bus. LCEBs deliver at least 30% saving in greenhouse gas emissions compared to a similar sized standard diesel bus.

Local authorities are also able to increase the demand for bus travel by directly influencing the in-vehicle time of a bus trip through bus priority measures and by altering the cost of using different modes.

There are also administrative savings to local authorities and bus operators from no longer having to separately claim and administer BSOG claims.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5%

- Local authorities maximise welfare from their spending. However, like central government they may not do this if they have particular equity or policy objectives;
- Local authorities offset the impact of fare increases and service reductions by using the devolved resource in a way that maximises welfare for their local area. This could be by using the devolved resource on transport interventions other than buses. Provided the returns to investment are at least as great as the return to BSOG, then this policy will increase overall welfare and improve value for money;

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: Unknown	**Benefits:** Unknown	**Net:** Unknown	No	Not applicable

EVIDENCE BASE

1 Background

1. The Department for Transport (DfT) has several overarching strategic aims, including supporting economic growth – both enabling growth and helping spread prosperity - and creating a greener transport system by reducing the environmental impacts of travel.

2. Buses are Britain's most-used form of public transport, with over 5 billion journeys a year, or nearly two thirds of all public transport journeys. Public revenue expenditure on buses in 2011/12 was around £2.3 billion.[2]

3. Bus patronage has been on a long term downward trend since the 1950s, but recent years have seen a gradual turnaround, led by London and smaller centres such as Brighton, Cambridge and Oxford, with the first year on year increases nationally in decades. These increases have been driven mainly by the introduction and extension of the national concessionary travel scheme from 2005/6 offering free travel for older and disabled people. However, experience in places such as Brighton shows how effective demand management and improvements to local bus services (such as increased frequency, imaginative fare structures and better real time information for passengers), as part of a package of measures, can deliver increases in bus patronage.

2 Problem under consideration

4. Bus Service Operators Grant (BSOG) is a payment made to bus operators by DfT for operating local bus services. It was first introduced in 1964, as Fuel Duty Rebate. The amount each bus company receives per year from Government in the form of BSOG is based on how much fuel their buses use during the year, with a flat rate paid per litre of fuel used. The rate varies according to the type of fuel; for the most commonly used fuel - diesel - it currently stands at 34.57 pence per litre (ppl).

5. BSOG represents the largest proportion of direct funding for the bus industry (outside concessionary travel, which is not a subsidy) with a budget of £360 million in 2012/13. In theory, competition in the bus market should ensure that BSOG results in bus operators running a wider network of services than they otherwise would do (see paragraphs 15-16). However, as BSOG is directly linked to bus fuel consumption, a bus operator would receive more subsidy if it increased its fuel consumption implying it is poorly linked to environmental objectives, particularly climate change. By artificially lowering the price of fuel, BSOG also reduces the commercial incentive on operators to invest in more expensive low carbon buses but which deliver longer term fuel (and therefore carbon) savings (see paragraphs 37-38), although where operators *do* invest in such buses they will receive a 6p per kilometre supplement above the standard BSOG rate.

6. As part of the last Government Spending Review, it was announced in October 2010 that the rate at which BSOG is paid would be reduced by 20% from April 2012. At the same time it was announced that the Government intended reviewing whether there were smarter ways of paying BSOG, with a view to making an announcement on the way forward by March 2012. Subsequently, on 26 March 2012, the Government published *Green Light for Better Buses*, which - amongst other things - set out the results of the review of BSOG and

[2] www.gov.uk/government/statistical-data-sets/bus05-subsidies-and-concessions (table bus0502)

announced that the Government intended launching a consultation on the details of how the proposed new regime for BSOG would work.

7. The system for paying BSOG to operators is administered by a unit within DfT. Whilst the same unit has in the past also administered the scheme on behalf of Wales, the Welsh Assembly was responsible for, and provided funding for, the BSOG scheme in their own devolved areas. Responsibility for paying BSOG in Wales passed from DfT to the four welsh regional transport consortia from 1 April 2013. The arrangements for paying bus subsidy in Scotland and Northern Ireland are devolved to the administrations in the respective territories. This impact assessment deals only with the proposed changes to the BSOG regime in England.

3 Rationale for intervention

8. There are market failures in transport which provide the rationale for intervention in the bus market. There are also equity reasons. The key market failures associated with transport are congestion and pollution. Government intervention in the bus market aims to correct for these externalities by encouraging mode shift away from car and subsidising the cost of low carbon emission buses. Equity reasons for bus subsidy are that bus users tend to have incomes that, on average, are lower than other transport users so subsidising their travel costs is progressive. For example, people in the lowest real income quintile make, on average, around 100 bus trips per year compared to only 32 trips per year for people in the highest real income quintile.[3] Subsidising bus services themselves also ensures people without a private car, particularly people in rural areas, have access to public transport. The subsidy options considered below set out how the current system could be improved and value for money increased.

9. Demand for bus travel has been in long term decline. A key reason for this has been rising car ownership. The empirical evidence suggests that the effect of increased incomes and car ownership is reduced bus travel. Specifically, the responsiveness of bus users to changes in their income (the income elasticity of demand for bus travel, including the impact of changed car ownership), has been calculated as lying between -0.5 and -1 in the long run.[4] In this example, a 10% increase in income leads to a 5-10% reduction in demand for bus travel. In the main, this is because the rise in income induces an increase in car ownership and therefore a reduction in demand for bus travel. In addition, the cost of car travel – inclusive of purchase costs - has fallen in real terms over time. The combination of these two factors has coincided with falling commercial bus patronage.

10. However, this is not to say falling bus patronage is unavoidable. Demand for bus travel will be adversely affected if the market is uncompetitive. An uncompetitive market will mean fares are higher than they otherwise would be and services less frequent. The Competition Commission in their recent inquiry has concluded that there is a substantial lessening of competition in the local bus market outside London and provided a number of remedies.[5] In addition, there are places where bus patronage has increased, most notably London, although outside of London local authorities such as Brighton have also experienced growth.

11. Evidence on what passengers value[6] suggests reliability and time savings are the most important determinants of bus demand. In addition, economic theory suggests altering the cost of alternative modes of transport increases the demand for bus travel. This is

[3] https://www.gov.uk/government/statistical-data-sets/nts07-car-ownership-and-access (table nts0705)
[4] http://www.demandforpublictransport.co.uk/TRL593.pdf page 24
[5] http://www.competition-commission.org.uk/our-work/local-bus-services
[6] http://assets.dft.gov.uk/publications/role-of-soft-factors-in-the-bus-market-in-england/appendices.pdf

evidenced through a cross-price elasticity of demand. There is research that suggests that the car price cross-elasticity is positive, particularly in the long run. Some studies quote a negligible short run cross price elasticity but a positive long run elasticity. One study suggests a car cross price elasticity of around 0.17 in the short run and 0.45 in the long run.[7] This suggests a 10% increase in the cost of running a car increases the demand for bus travel by 1.7% in the short run and 4.5% in the long run.

12. Falling bus patronage is a concern on economic and environmental grounds if there are external costs imposed on the rest of society, most notable higher congestion and pollution levels. The DfT forecasts the average delay on roads in London, Large Urban and Other Urban areas in England to increase by 20%, 22% and 18% respectively from 2010 to 2020.[8] This provides a rationale for intervention.

4 Background on BSOG

13. The main form of support for bus services outside of London is BSOG. In theory, in a competitive market, bus operators should “pass on” BSOG to consumers in the form of lower fares, more frequent bus services and / or better quality buses. However, bus operators alone are unable to reverse the long-term decline in demand for bus travel.

14. BSOG is currently paid to bus operators at a rate of 34.57 pence per litre (ppl) of diesel on the fuel consumed in the operation of local bus services (though at a lower rate for certain less-commonly used fuel such as natural gas or used cooking oil). We estimate that, on average, each bus consumes around 27,000 litres of fuel per year.[9] This implies the average BSOG payment per bus is around £9.3k (27,000 x 34.57p) per year.

15. The existence of BSOG means bus operator costs are lower than they otherwise would be. As of March 2012[10], the resource cost of diesel was 63ppl and the fuel duty rate was 58ppl. This implies that with BSOG net bus operator fuel costs are 86ppl.[11] Without BSOG, net bus operator fuel costs would be 121ppl (63ppl + 58ppl). This implies removing BSOG will increase bus operator net fuel costs by around 41%.

16. The latest Confederation of Public Transport (CPT) data suggests fuel represents around 15% of total bus industry costs.[12] This implies that, on average, BSOG helps lower bus industry costs by around 6% (15% of 41%). As a result, in a competitive market bus operators will charge a lower fare and / or operate a larger network than they otherwise would do (it is likely that bus operators would offer a combination of lower fares and more services).[13]

17. Bus operators (outside London) are able to claim BSOG for both ‘commercial’ – deregulated services independent of local authorities – and ‘supported’ (tendered) services - those bus services which a local authority decides to procure directly (usually in areas of low demand where bus operators feel there is not a commercial case for operating). Commercial services represent the bulk of bus mileage – around 79% in England outside of London in 2011/12[14] – with supported services representing the remainder. For supported services,

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[7] http://www.demandforpublictransport.co.uk/TRL593.pdf p44

[8] http://assets.dft.gov.uk/publications/road-transport-forecasts-2011/road-transport-forecasts-2011-annex-miles.xls

[9] Estimate derived from analysis of BSOG expenditure.

[10] http://www.decc.gov.uk/assets/decc/statistics/source/prices/qep411.xls

[11] 63ppl + 58ppl – 35ppl = 86ppl

[12] http://www.cpt-uk.org/_uploads/attachment/2201.pdf

[13] In a competitive market we assume the subsidy is competed away so that it benefits consumers in the form of lower fares and / or more frequent services.

[14] https://www.gov.uk/government/statistical-data-sets/bus02-vehicle-distance-travelled (table bus0205)

bus operators bid for the right to operate such routes taking into account any potential BSOG they expect to receive from the DfT. Our best estimate is that around £50m of the BSOG budget is for supported services, with a further £93m for services within London.

18. In London, the bus market is entirely franchised. This means Transport for London (TfL) decides which fares to charge and what the size of the network of bus services should be. They then invite operators to bid for the right to run services on particular routes. Once the contract to operate such routes is 'won' by an operator, they can claim BSOG from DfT over the lifetime of the contract. So, individual operators would take into account the amount of BSOG they would be able to claim for these services in how high they pitch their bids. Similar arrangements apply outside London, where operators submit bids to run supported (tendered) services.

5 Policy objective

19. The key policy objective of the proposed reforms to bus subsidy is to encourage greater patronage growth which in turn will help achieve mode shift and lower congestion. Reducing carbon emissions from buses by increasing incentives on bus operators to invest in more fuel efficient buses is an additional objective.

20. The Department has been considering a wide range of potential options for reforming the support available to the bus industry. After discussion with the industry and consideration of these options, the Department developed a set of proposed reforms, which were announced in March 2012. As well as continuing discussions with the industry, the Department held a wider public consultation on the proposed changes between 13 September and 12 November 2012. This Impact Assessment sets out the analysis underpinning the proposed set of changes to the current BSOG system, and analysis of the main options for reform.

21. The proposed approach to reform includes specific changes in the short term to how the bus industry is supported through BSOG. In addition, the Department has also announced its intention to look again at certain aspects of the regime in the medium term, whilst setting out its intention to break, in due course, from the current system of paying subsidy based on fuel usage.

6 Summary of options and estimated costs and benefits[15]

6.1 Policy Option 1 – Keep BSOG in its current form - 'do nothing'

6.1.1 Background

22. This option is a 'do nothing' approach i.e. continuing to pay a subsidy linked to fuel consumption and not devolving any of the funding to local authorities. As the analysis in paragraph 16 suggests, BSOG helps ensure bus operator costs are around 6% lower than they otherwise would be. This means bus operators are able to charge a lower fare and run a larger network than they otherwise would do. However, as this policy option represents a 'do nothing' option there are no costs and benefits from pursuing this option.

[15] The new National Bus Model (NBM) recently developed by MVA for DfT has been used to provide some of the quantitative analysis in this IA. Robust testing of the model is currently being undertaken and so the analysis may be subject to change – though in the unlikely event of further changes to the model, the results are not expected to change significantly.

6.2 Policy Option 2 - Devolution of BSOG funding for certain services to Local Authorities

6.2.1 Background

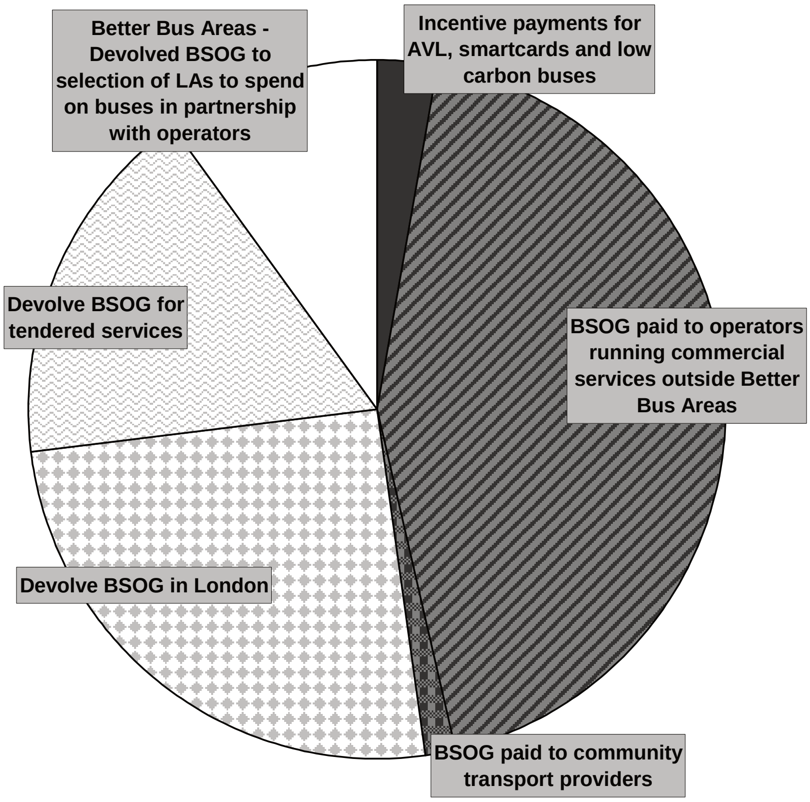
23. This option would involve devolution of part of the existing BSOG budget to local authorities, effectively as a grant. Therefore, BSOG funding would be devolved to individual local authorities rather than being paid to bus operators. It therefore fits with the longer term goal of devolving powers and responsibilities to local government. As set out, it comprises:

- devolving all BSOG for supported bus services (but not commercially viable ones) to individual local authorities outside London;
- devolving all BSOG funding in London to Transport for London (TfL) or the Greater London Authority (GLA) where a franchised system operates;
- devolving BSOG funding for both supported and commercial services to a small number of local authorities outside London who fall within a "Better Bus Area", as designated by the Government through a bidding competition.

24. These new arrangements would not apply to the following services, whose operators would still be able to claim BSOG direct from DfT:

- services in London which are not franchised by TfL;
- commercially viable bus services outside London;
- services operated under a "section 19" permit by community transport groups, such as those providing transport for disabled individuals or persons over 60.

Figure 1: A chart illustrating the split of BSOG funding under policy option 2



25. The lightly shaded portions of Figure 1 illustrate the parts of BSOG impacted on by policy option 2. The dark shaded areas show the parts of BSOG that will continue as currently operated.

6.2.2 Devolution of tendered services outside London

6.2.2.1 Rationale for reform

26. It is already up to local authorities outside London to decide which services they wish to put out to tender in their areas in order to fill gaps in the network of bus routes being run by the bus operators. Given this, there is a strong argument that BSOG which would otherwise be paid to the bus companies operating these 'supported' services should instead be paid direct to authorities.

27. In effect this would create an opportunity for the latter to use this funding alongside their funding to improve accessibility in their area by purchasing socially necessarily but uncommercial services. This would allow them to look across their areas and decide what local people's highest priorities are for filling gaps in the network of buses run commercially by the bus companies, whether this be services outside peak hours or services to areas which are poorly served by public transport at the moment. They could also choose to expand the number and range of community transport services in their area if they felt that these would be more suitable than "conventional" bus services.

28. Under the current system, there are several 'steps' to follow for bus operators and local authorities (and TfL) during the procurement of a supported or franchised route over the lifetime of the contract. They are as follows:

    <u>*Bus operator*</u>

    1. Estimate the likely costs of running a service, including estimated fuel use;
    2. Estimate the potential revenue flows from the contract, taking into account whether the contract is to be let on a gross or net basis;[16]
    3. Submit a bid to a local authority for running the route;
    4. If the bid is accepted, run the service and separately claim BSOG from the DfT.

    <u>*Local authority*</u>

    1. Assess all tenders and award the winning tender to the relevant bus operator;
    2. Pay agreed subsidy to the 'winning' bus operator.

    <u>*DfT*</u>

    1. Calculate and check estimated claim by the bus operator;
    2. Release BSOG quarterly based on the estimate claim to the bus operator for running the supported or franchised service;
    3. At end of year compare final claim with the earlier estimate and either pay difference where former is higher or recover the overpayment where latter is higher.

29. There is, therefore, an administrative cost to the bus operator, local authority and DfT in the procurement and operation of a supported or franchised contract.

30. So, there are potential efficiency savings that can be made from devolving the supported and franchised component of BSOG to local authorities and TfL/GLA. This would streamline

[16] If a contract is let on a [net] cost basis the bus operator retains any passenger revenues while a [gross] contract means the local authority retains the passenger revenues. The latter means the revenue risk lies with the local authority rather than the bus operator.

the administrative process and result in some cost savings to the DfT and to those bus operators not claiming incentives. There are also potential wider carbon benefits by encouraging bus operators to conserve fuel and invest in low carbon emission buses. Each of these is described below.

6.2.2.2 Benefits

6.2.2.2.1 Achieving efficiency savings

31. Devolving the supported or franchised component of BSOG to local authorities and TfL/GLA would – in cash terms – be a simple transfer between central and local government. In effect, the net public sector subsidy costs for running a supported or franchised contract would be unchanged. This is because a bus operator would now receive the entire subsidy from one public sector body (in this case a local authority) rather than from two separate public sector bodies (local authorities and the DfT) – except where an operator continued to claim incentive payments from DfT. However, while the net public sector subsidy costs are unchanged, there would be administrative cost savings to the public sector and bus operators. The revised steps involved for bus operators and local authorities (and TfL/GLA) during the procurement and lifetime of a supported or franchised contract would be as follows:

    <u>Bus operator</u>

    1. Estimate the likely costs of running a service, including estimated fuel use;
    2. Estimate the potential revenue flows from the contract, taking into account whether the contract is to be let on a gross or net basis;
    3. Submit a bid to a local authority for running the route;
    4. Those operators who claim for incentives will need to continue to claim separately from DfT.

    <u>Local authority</u>

    1. Assess all the tenders and award the winning tender to the relevant bus operator;
    2. Release funds to the ‘winning’ bus operator.

32. For a bus operator, there is **no** theoretical increase in net costs. This is because they would already have estimated the likely fuel requirement for a particular route as part of their claim to DfT for BSOG. If the bus operator is no longer able to claim BSOG on such services, they would simply factor in the higher fuel cost of running the service when submitting their bid for new contracts to the local authority. Given the estimated fuel use would already have been calculated, there would be no increase in costs from this measure to bus operators. In relation to existing contracts we would expect local authorities to review these to see how they would need to be adjusted to take account of the loss of BSOG by operators.

33. As bus operators would no longer separately claim BSOG from the DfT, there is an administrative saving to bus operators from removing this step in the process. However, bus operators have said that the administrative cost of claiming BSOG is relatively small, as the data they are currently required to submit to DfT to support their BSOG claims is already produced as a by-product of running their operations.

34. Devolving BSOG funding to local authorities would not mean that each authority would need to set up a new unit – replacing the single centralised unit currently operated by DfT – for paying BSOG direct to operators. Instead, each local authority would continue to act as they were before, assessing each bid from operators to run a service and awarding the contract accordingly. The only difference would be the costs of running a supported or franchised route would be higher, as operators’ bids would take account of the fact that they would no longer receive BSOG for running the services. However, this would not be a cost to local

authorities as the costs involved in the assessment of tenders would still be the same and the devolved funds from DfT would cover the additional tender costs that bus operators would charge.

Central Government

35. Another key difference is that the DfT would no longer administer BSOG for supported or franchised contracts. This means there is an administrative benefit to the DfT. However, we estimate this to be relatively small as the total staffing costs for the team administering BSOG is £282k and only a quarter of staff time is estimated to be on TfL and supported service claims. In addition, as there will also be additional administrative work required to calculate appropriate levels of bus subsidy for BBAs, these administrative benefits will be negated. As such, we believe there is no net administrative benefit to the DfT from this option.

6.2.2.2.2 Achieving larger environmental benefits

36. The other key benefit is that while the net costs of running a route will be unchanged for bus operators, there will be potential wider external carbon benefits from the changes. In particular, the devolution of BSOG for supported and franchised routes will effectively mean bus operators no longer receive a direct subsidy on their fuel consumption. In effect, the current BSOG system lowers the cost of fuel which means bus operators have less of an incentive to improve their fuel efficiency and invest in low carbon emission buses and eco-driver training than if they were paying the full cost of fuel.

37. However, the increase in net fuel costs gives a greater incentive on bus operators to conserve fuel and invest in low carbon emission buses and eco-driver training. Low carbon emission buses deliver at least a 30% saving in greenhouse gas emissions compared to a similar sized standard diesel bus. Despite these buses saving each bus operator around 30% in fuel costs over the lifetime of the bus, the high upfront cost – around £100k more than a standard diesel bus – deters investment in these vehicles. However, devolving BSOG for supported and franchised routes will mean bus operators incur the full cost of fuel which improves the business case for investing in low carbon emission buses.

38. We estimate the present value benefits (3.5% discount rate) from investing in a low carbon bus over 15 years – the assumed lifetime of a bus - to be around £110k. However, if bus operators were not in receipt of BSOG, the present value benefits would be £140k (see footnote). Therefore, detaching bus subsidy from fuel consumption improves the business case for investing in low carbon emission buses by a further £30k[17] and places a greater incentive on bus operators to conserve fuel. This means there are likely to be improved environmental outcomes in terms of lower bus CO_2 emissions from this policy.

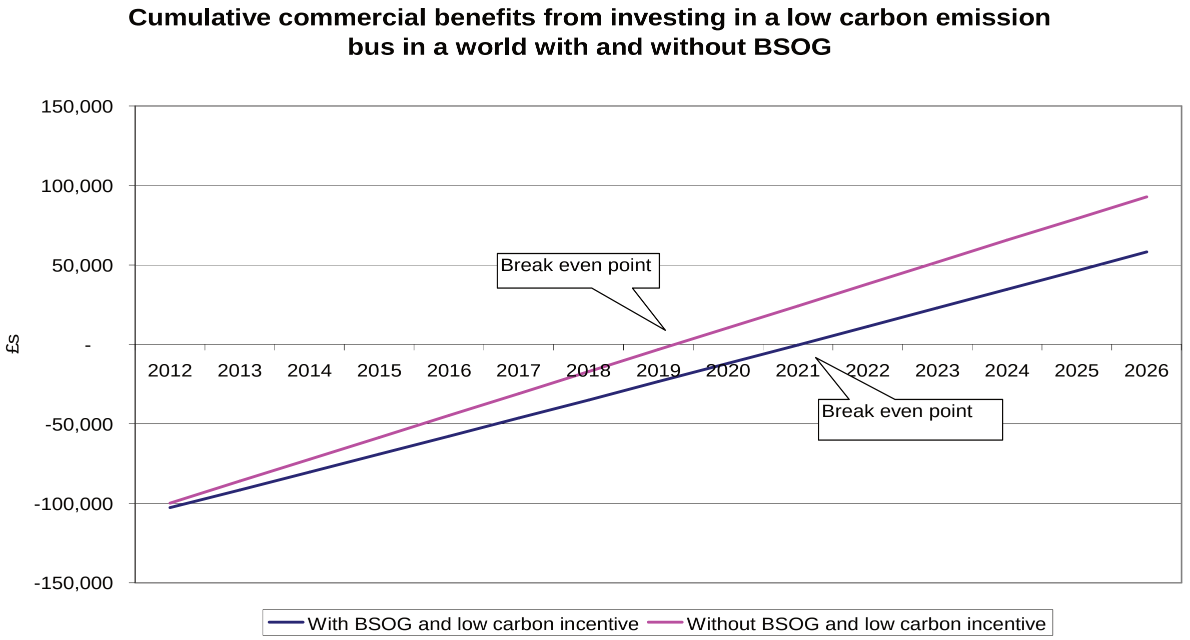
39. A chart illustrating the estimated "pay back" period of a low carbon emission bus in a world with and without BSOG is illustrated below. The key point is that the 'break even' points from investing in a low carbon emission bus is around 2 years less in a world without BSOG

[17] The annual fuel cost saving is on average £2.4k per bus. Calculation shown below:
2012 fuel price (resource + fuel duty) = 118.78 pence/litre (2011 prices)
2012 BSOG real price = 33.76 pence/litre (2011 prices)
Fuel consumption of standard bus = 27,000 litres (30% less for a low carbon bus)
Additional low carbon incentive paid to a low carbon bus at 5.86 pence/km (2011 real price)
Average kms travelled by a bus in England in 2010/11 = 68,000 kms
So, net fuel cost (standard bus) in 2012 = (118.78 -33.76)*27,000 = £23k
Net fuel cost of a low carbon bus in 2012 = (118.78 -33.76)*(27,000*0.70) – (5.85*68,000) = £12k
Therefore, fuel savings in 2012 = £23k - £12k = £11k.

However, when BSOG is removed and the above calculations are repeated (BSOG = 0), then net fuel cost (standard bus) = £32k.
Net fuel cost of a low carbon bus = £18k. Hence fuel savings = £32k – £18k = £14k per year.
When compared to the world in which BSOG exists where fuel savings were £11k, you make an extra £3k saving per year when BSOG is removed.

(note we have assumed bus operators receiving BSOG continue to be able to claim a small low carbon incentive when purchasing a low carbon emission bus). Additionally, the return on investment for operators is 5% per annum in a world with BSOG against 9% in a world without BSOG. Higher rates of returns will further incentivise the take-up of low carbon buses.

Figure 2: A graph illustrating the estimated commercial cumulative fuel savings and 'break even' point from a low carbon emission bus in a world with and without BSOG



6.2.2.3 Costs

40. The key drawback with this policy is the fact that devolving BSOG based on current spending on supported services, could effectively 'reward' those local authorities who plan to reduce their spending on supported services – as they can 'bank' the devolved funds and not use them on supported bus services – and 'penalises' those local authorities who plan to increase their spending on supported services – as they will not be entitled to BSOG for 'newly' tendered supported bus services. Whilst the Government does not currently plan to review the amounts to be devolved to each local authority once these have been calculated – and whilst the Government's ultimate intention is that funding paid direct to local authorities should not be ring fenced - it nevertheless intends to ring fence until the end of 2016/17 the devolved BSOG funding for a transitional period in order to avoid unnecessary turbulence in the bus market and to provide protection for passengers during this transitional period. During this period, the devolved grant will have to be spent by local authorities on measures directly related to bus services. In addition, there is potentially a small cost to local authorities who might face reduced competition for tendered services if some operators who currently bid for contracts find that no longer receiving BSOG reduces their ability to compete for that contract. This would have the effect of reducing competition and potentially increasing prices for local authorities.

6.2.3 Devolution of BSOG funding in London

41. Currently London operators receive BSOG from DfT in the same way as operators outside London. This option would see a grant paid directly to Transport for London (TfL) or the Greater London Authority (GLA), instead of paying BSOG to London operators who are

contracted to TfL. This would be paid through a combination of grant from the Department and under new proposals to fund the GLA via Business Rate Retention. Operators not under contract to TfL – for instance those operating services on routes which run partly within and partly outside London - would continue to claim BSOG as now. Under this option the majority of operators in London would no longer be entitled to claim BSOG. This will have little impact on the bus operators as contract prices will change to reflect the fact TfL receive this payment rather than the operator. As a result, the same benefits achieved by devolving BSOG for supported services are achieved with this measure. However, the transition will need to be carefully handled to avoid short term disruption for operators already under contract to TfL.

6.2.4 Establishment of "Better Bus Areas"

6.2.4.1 Rationale for reform

42. In a recent report into the bus market, the Competition Commission recommended that, as part of its current review of BSOG in England, the DfT considers ways of incentivizing the following activities:

- development of, and participation in, effective multi-operator ticketing schemes;
- compliance with competition law and the Code of Conduct; and
- investments through partnership arrangements aimed at growing passenger demand.

43. The Government agrees that it would be possible to use the payment of BSOG to encourage local transport authorities and bus companies to work closely together to improve services and boost passenger numbers. In order to do this we are enabling local transport authorities to apply to be designated as a "Better Bus Area" (BBA), where they can show that they have a clear plan for improving bus services in their area that is being developed locally in partnership with bus companies. A BBA can cover either part or all of an authority's area, alternatively two or more authorities could join together to create a BBA across part or all of their joint areas.

44. Where a BBA is established, the Government will calculate how much commercial BSOG is paid each year to all bus companies operating services within the area covered by the BBA. Within BBAs the amount of commercial BSOG claimable by operators will then gradually be reduced to zero across the 4 ½ year term of the BBA, with the relevant local transport authority receiving a gradually increasing annual grant equal to the BSOG foregone by operators plus an annual additional 'top-up' fund, equivalent to 20% of commercial BSOG within the defined BBA.

6.2.4.2 Benefits

45. As local authorities and bus operators will have to jointly bid to become a BBA, DfT will separately appraise each individual bid to assess its value for money. Value for money (vfm) is one of the criteria used to select successful bids, along with evidence of a sound partnership approach between local authorities and bus operators to deliver a clear set of objectives.

46. The recently launched BBA pilot in Sheffield has provided the Department with information on the likely vfm of future BBA rounds. The measures proposed in Sheffield are expected to grow bus patronage, reduce journey times, deliver reductions in congestion, and reduce carbon emissions. The Benefit Cost Ratio of the BBA pilot in Sheffield is estimated at 2.5, i.e. there are £2.50 worth of benefits per £1 of cost. This is higher than the current BSOG system.

47. As local authorities have the ability to directly influence key determinants of bus demand – for example improving the level of reliability and journey time through bus priority or through altering the relative costs of different modes – then provided the resource is used to support bus services, devolving BSOG to local authorities is likely to yield higher returns in the form of higher patronage levels than if the support went directly to bus operators. As higher patronage levels relative to the status quo will mean lower congestion levels, there will be higher external benefits with this measure than if BSOG continued to be given directly to bus operators.

6.2.4.3 Costs

48. The Department will provide an additional sum per year to be devolved to Better Bus Areas in the form of a "top-up". This is to provide the incentive to bus operators to become a BBA in partnership with their local authority. The additional "top-up" sum per year is a cost to the DfT.

49. By encouraging local authorities and bus operators to jointly bid to become a BBA, there is a theoretical risk that potential competition could be reduced.

50. In the absence of any local authority measures to improve the bus service, devolution of funding to BBAs would cause commercial fares to increase and services to reduce. We estimate that with no action total costs could increase by 6% and that this would be reflected in a 4% increase in fares or a 6% reduction in services (or a combination of both). The market is currently deregulated outside London, meaning fares and services are decided by bus operators on a commercial basis. By growing bus patronage BBAs should make the bus market more commercially viable, freeing the operator from the need for direct public subsidy.

51. Carbon emissions can increase as a result of bus measures. This is because, unless local authorities are able to encourage significant mode shift, there will be an increase in bus mileage (and therefore CO_2) that will not be offset by a reduction in car CO_2. This was a finding from the recent £70m BBA fund where the majority of bids received were forecast to increase carbon emissions.

52. The competition has therefore been designed, so that only bids that lead to reductions or neutrality in net CO_2 are approved. This would mean there would be no net increase in CO_2 emissions.

53. There is a cost to the DfT in administering a more complex bus subsidy programme, though this should be negligible (cost as yet unknown).

6.3 Option 3 - Devolution of all BSOG to Local Authorities

6.3.1 Background

54. This option would involve devolving all of the existing BSOG budget to local authorities – not just that paid to support franchised and tendered services, but also that going to services outside London which are run on a commercial basis. It means bus operators will not be in direct receipt of bus subsidy and local authorities are free to use the resource as they see fit. The impact of this option depends crucially on how the local authority decides to use the devolved resource.

6.3.2 Benefits

55. The clear advantage of this option is that local authorities can spend the resource in areas where the returns are highest. The devolution of bus subsidy enables flexible and tailored responses according to an individual local authority's needs. However, many otherwise effective ways of subsidising buses might not comply with European legislation on state aids. This substantially limits local authorities' powers to act, reducing the overall effectiveness of local authority interventions in many areas – particularly where there is limited congestion or opportunity for infrastructure improvements.

56. By fully delinking subsidy from fuel, this option also maximises the potential carbon benefits that can be achieved by making bus operators incur the full cost of fuel. Unlike Policy Option 2, subsidy is fully delinked from fuel rather than only delinked for particular areas. As a result, there are greater incentives on bus operators to conserve fuel and invest in more fuel efficient buses. As a result, the potential carbon benefits of this option are higher than with Policy Option 2.

57. In addition, the recent Competition Commission inquiry has concluded that the bus market is uncompetitive. This finding means we can be less sure of how any bus subsidy is translated into consumer benefits. There is therefore an argument for diverting bus subsidy to local authorities who can use the devolved resource as they see fit.

58. As with Policy Option 2, there are also additional administrative benefits to the DfT, local authorities and bus operators who no longer need to claim or administer BSOG. These benefits will be higher than under Policy Option 2, given BSOG would be fully devolved.

6.3.3 <u>Costs</u>

59. The drawback of this option is that in the short term, the loss of BSOG may lead to an increase in fares charged to passengers on commercially-operated routes and bus mileage contracting. We estimate that total costs would increase by 6% which will either be reflected in a 4% increase in fares and a 6% reduction in services (or a combination of both). While reduced commercial services can be mitigated by local authorities "buying back" services through a competitive tender, authorities would not be able to influence commercial bus fares.

60. An additional drawback is that local authorities may not maximise welfare from the resource devolved. However, such an argument only holds if central government maximises welfare from its spending. Like local authorities, central government may have particular equity and strategic policy objectives which mean maximising value for money from all spending is not always achieved.

7 Miscellaneous

61. The Government believes that the underlying purpose of BSOG is to support local bus services. However, the current legal definition of local services as set out in regulations has enabled the operators of several other types of services to claim BSOG which the Government considers do not strictly come within the remit of local bus services. At a time of intense pressure on the public purse, the Government believes that it is important that BSOG funding is focused on supporting truly local services. Therefore it announced in March 2012 that it intended to tighten the qualification criteria for receiving BSOG to exclude certain categories of service which can receive BSOG at present. Having taken into account the comments which we received during the consultation (see Section 8 below), we have now decided that the following service types would be excluded in future:

- bus services put in place to replace rail services on a temporary basis;
- services which are primarily for the purposes of tourism, such as tour buses;
- services whose primary function is to transport travellers between rail stations, airports or sea terminals and dedicated car parks;
- short term special services intended to operate for less than 6 consecutive weeks, for instance those serving flower shows or sporting events.

62. There is limited information available on how much subsidy funding goes annually to these services, as these are not necessarily identified as being such services when bus operators submit claims for BSOG. However, we used last autumn's consultation process to gather more information on the likely impact of exclusion on the operators of each of these service types. In the light of concerns expressed during the consultation, the original list of services which it was proposed to make ineligible for BSOG has been narrowed so as not to exclude certain types of service, including:

- those services which are primarily there to serve local communities but which are also popular with tourists, for instance in areas such as Cornwall or the Peak District;
- short term services which are intended to fill unexpected gaps in existing services, for instance where the existing operator goes out of business at short notice or where there is temporary damage to existing road infrastructure such as a bridge;
- those limited route sections of longer distance coach services where stops are less than 15 miles apart and which therefore can play an authentic role as local bus services.

8 Public consultation exercise

63. The Department for Transport ran a public consultation between 13 September and 12 November 2012 seeking views on how the reforms set out in the March 2012 publication, Green Light for Better Buses, should be implemented.

64. An electronic version of the consultation document can be found here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/9112/consultation-response-form.pdf

65. Sixteen questions were posed within the consultation document and those responding were encouraged to explain their position on each of the points. A total of 143 responses were received; 28 were general comments on the Government's proposals and overall bus policy approach, 115 were fuller responses to the questions in that they responded to the majority of questions but left either blanks or statements such as 'no comment' to questions which they felt were less applicable to their particular circumstances. The largest responding category type was 'local government', accounting for 42% of all responses, followed by 'large bus operator', which contributed 13%.

66. Responses to the consultation from across the sectors indicate a underlying caution and some concerns over the prospect of change. A summary of responses to a selection of key questions is set out below:

- on the proposed method for calculating BSOG to be devolved to local authorities, 32% of responses agreed with the proposed method of calculation, 57% disagreed and 11% provided no clear answer;

- on the proposal to devolve all funds on a single date 50% of respondees agreed, 39% disagreed and 11% provided no clear answer;
- when asked if there was a need to ring fence devolved BSOG funding, 83% agreed, 10% disagreed and 7% gave no clear answer;
- on the proposed approach to partnership within BBAs 59% of responses agreed that the proposed approach struck the right balance; 23% disagreed and 18% gave no clear answer;
- on the proposal to phase out BSOG within c. 6months in BBAs, 38% agreed, 44% disagreed and 17% gave no clear answer.[18]

67. The primary purpose of the consultation was to gain insight into how best the reforms should be delivered. As a result, the DfT gained useful information in a number of relevant areas from contributions which came from across the industry, including the bus and coach industry, private individuals, local authorities, and representative groups.

68. The Department has considered all responses and the analysis was used in the drafting of this updated Impact Assessment. A formal response to the consultation exercise, and summary of the responses to the consultation, is being published at the same time as this IA. This also sets out the timing for the delivery of the reforms.

9 Impact on concessionary travel reimbursement

69. The exact regional impact of BSOG reform under Option 2 on concessionary travel reimbursement will depend on the bus market characteristics of the local authorities where BSOG is ultimately devolved and on the local authorities' response to the changes. The impacts are therefore likely to be localised and are likely to differ depending on whether local authorities take mitigating measures such as widening the scope of public service obligations.

70. Considering first the devolution of commercial BSOG in Better Bus Areas (using the Department's reimbursement calculator, which is published and used by bus operators and local authorities) we have estimated the potential impact of this reform on reimbursement payments. The estimates below are based on the devolution of some 13% of BSOG through the Better Bus Areas. However, this figure is not fixed and will depend on the quality of the bids received. If however, 13% of BSOG were devolved we then assume that 13% of total reimbursement will be affected by the changes, a total of £90 million in 2011/12 prices.

71. The baseline impact of devolving BSOG, without taking any compensatory action is that fares may increase by 4% and service levels may decrease by 6%, as discussed in this IA. Under such a scenario we would expect reimbursement to increase by 4.7%, or approximately £4.5 million a year (which represents 0.65% of the total reimbursement estimated for England excluding London in 2012/13).

72. However, Better Bus Areas are intended to improve the bus market, through local authority action. This is expected to result in a mix of increased services, reduced fares or both

73. If the impact of a BBA is that fare and service levels remain constant then we would expect reimbursement to increase by around 7.7%, or approximately £7 million (which represents 1% of the total reimbursement estimated for England excluding London in 2012/13). This is due to the fact that marginal costs for operators will increase once BSOG is removed and this increase in costs will require reimbursement.

[18] Percentages have been rounded therefore they may not total to 100%

74. If the impact of a BBA is that service levels increase but fare levels remain constant, then we would anticipate an increase in reimbursement above the £7 million calculated above. Conversely, if the impact of a BBA is that service levels remain constant and fares fall then we would anticipate an increase in reimbursement that would be less than £7 million (and in some circumstances reimbursement may fall).

75. Unfortunately, given the local nature of a BBA it is not possible to estimate with any accuracy the impact on concessionary travel reimbursement.

76. For supported services, whilst the cost of carrying concessionary passengers will increase, it is not expected that there will be an increase in concessionary travel reimbursement. This assumes that local authorities will increase the price of the tender to exactly match the reduction in BSOG. If concessionary travel reimbursement were to increase, this would be a sign that the operator was being made better off than they would be in the counterfactual whereby no concession exists.

77. A similar situation is expected to occur in London, whereby the reduction in BSOG theoretically causes concessionary travel reimbursement to increase but this is not realised as the increase in costs is covered by an increase in tender prices.

10 Impact on Micro-businesses

78. The selective devolution to local authorities of the BSOG funding, which is currently paid to bus operators for operating local services, would apply to any operator regardless of size. As explained elsewhere in this impact assessment, the exact impact of this change is unknown at this moment as it will depend upon how individual local authorities use the devolved funding to support transport services in their area, both inside and outside Better Bus Areas. However, given that the rationale of devolving funding for tendered services is to allow local authorities to use the funding to look across their areas and identify what are the local priorities for filling gaps in the network of commercial services run by bus operators, we do not believe that it would be appropriate to exempt micro-businesses from the proposed changes. For a similar reason, in the case of Better Bus Areas - where authorities would need to work closely with operators of all sizes in deciding how the devolved funding would be spent – we believe that that devolution should also apply to smaller operators.

11 One In Two Out status

79. We consider that the proposed changes fall outside the scope of the *"One-in, Two-out"* rule. The changes proposed – and the revisions needed to existing regulations to achieve them – concern the way in which subsidy, in the form of BSOG, is paid to support bus services. As such, this relates to spending decisions, as described in section 16vii of the Government's *One–in, One-Out Methodology*[19], as currently applied to the "One-in, Two-out" rule.

12 Conclusions

80. On consideration, the Government has decided to take Policy Option 2 forward.

81. As it is already up to local authorities to decide which services they wish to put out to tender in their areas in order to fill gaps in the network of bus routes being run by bus companies, it would make more sense for the BSOG which would otherwise be paid to operators to be paid direct to authorities instead. This would in effect create an opportunity for authorities to

[19] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31616/11-671-one-in-one-out-methodology.pdf

use this additional funding alongside existing funds to improve accessibility in their area by buying in socially necessary services which would not otherwise be commercially viable. This would also allow them to look across their areas and decide what local people's highest priorities were for filling gaps in the network of buses run commercially by operators whether this be services outside peak hours or services to areas which are poorly served by public transport at the moment. They could also choose to expand the number and range of community transport services in their area if they felt that these would serve local communities better than more conventional services.

82. Equally, as most of the funding from central Government to support transport in London is currently paid to TfL in the form of a single unified grant, the Government believes that there is a strong case for paying to TfL/GLA the BSOG which is currently paid directly to the bus companies running services in London. So, we propose to proceed on this basis.

83. Finally, we believe that the establishment of Better Bus Areas will provide a strong incentive for local authorities and operators to work closely together to improve bus services in their area. They should prove an impetus for bus companies to improve their fuel efficiency and reduce their carbon emissions over the next few years.

Longer term reform

84. The Government has considered the case for also devolving to individual local transport authorities the BSOG currently paid to bus operators for commercially viable services outside London (i.e. in effect Policy Option 3). On the one hand this would allow local transport authorities to take a broader view across their areas as to how public transport could be improved and use this funding to make a real difference. Set against this, taking this funding away from bus companies across England in this way, regardless of local circumstances and the relevant local transport authorities' readiness to spend the recycled funding effectively, could have serious implications for those people who live where bus routes and services are only just commercially viable at the moment.

85. Given the uncertainty affecting the bus sector at the moment, we do not believe it is sensible to embark on open-ended, wholesale change to residual BSOG funding in the short-term through full-scale devolution. Instead, we believe that it would be better to allow the reforms to the BSOG system outlined under Policy Option 2 to settle in before introducing further change. So, we will monitor how effective individual Better Bus Areas are in improving bus services in their areas.

86. In the longer term, the Government believes that the case for moving away from payment by fuel use is a compelling one. However, before replacing this with a new basis for payment we would need to understand better the likely effect of different options on local bus markets and service levels in different areas of the country. Therefore, we intend to carry out a review of the options for replacing fuel use by the end of 2014 and to come forward at that point with a firm proposal for change. We will also review then the case for further devolution of funding.

13. Analytical Assurance Statement

87. The level of assurance of the analysis underpinning this Impact Assessment is considered to be **‘medium-high’** because of the analytical tools used and the level of scrutiny that has been undertaken by experienced and skilled staff in the Department.

- The analysis of BBAs under policy option 2 is based on the cost-benefit analysis undertaken for our pilot BBA area in Sheffield which used a light-touch approach to appraisal. The approach taken was consistent with WebTAG and available local economist resource has allowed for sufficient exploration of uncertainties around the costs and benefits. However, constraints on time have meant that the analysis was not peer reviewed by other analysts in the department. Peer review of the analysis would have increased the level of assurance but we believe sufficient sensitivity analysis has been undertaken to increase the reliability of the analysis.
- Analysis elsewhere in the IA relies on simple fuel cost calculations and uses the published low carbon bus calculator to estimate the impacts of low carbon buses which have been validated and subject to challenge from other analysts in the department.
- The National Bus Model (NBM) was used to estimate the impacts of removing BSOG on fares and service levels. A sufficient level of QA of the NBM has been undertaken with regards to model accuracy and reliability and the model control environment. The analysis carried out using the NBM has been validated by two economists and the underlying assumptions uses elasticities accepted by industry. Though the model has not yet been exposed to external challenge/peer review, the amount of testing that has been carried out by the model developers means that further external peer review is not expected to reduce the level of model risks significantly.

88. Overall, the level of uncertainty in the analysis used in this IA is expected to be relatively low, given the use of tried and tested methods, and considering that time and resource given to the analysis has been proportional and sufficient.