4.3 USING BUSES TO SECURE SUCCESSFUL OUTCOMES IN GROWING AND CONGESTED URBAN AREAS

Headlines:

- **Buses are a fundamental part of the urban transport network.**
- **The bus sector has been in long-term decline since its peak in the 1950s. This aggregate picture masks real differences in outcomes observed in different urban areas in recent years: the market is expanding in some areas, especially London, but is shrinking rapidly in others while congestion continues to grow – the problem is especially acute in the areas covered by the Passenger Transport Authorities.**
- **Securing the effective operation of buses in urban areas requires some important policy choices. This includes, where appropriate: mechanisms for strengthening competition; decisions on bus investment; and demand management where congestion is growing.**
- **Getting this right has clear benefits: supporting the growth of urban areas; securing environmental and social benefits, including accessibility; as well as contributing to the successful delivery of road pricing.**
- **In the UK, prior to 1986, buses were owned and controlled by government. In 1986 competition was introduced into the sector. Following deregulation, London adopted an 'off-road' competition for the market model through franchising, while the other urban areas adopted an 'on-road' competition for the consumer model.**
- **The necessary building blocks for using buses to secure successful outcomes in growing and congested urban areas are: 'competition' forces; 'coordination' of services; and 'cooperation' between operators and local authorities. The fundamental question is what blend of these 3Cs will be effective in different urban areas in the UK.**
- **There are three broad options that urban areas might adopt to deliver bus services: (i) the current model of 'on-road' competition for the consumer; (ii) partnership working with some limited "on-road" competition; and (iii) franchise model with 'off-road' competition for the market. Underlying each of these options is the principle of employing competitive forces. There is no evidence to suggest that there should be a return to the pre-1986 era where government owned buses.**
- **It is not clear that any one option is necessarily superior or best suited across all urban areas at any one time. But it is clear that the current position in many urban areas can be improved. In particular, the evidence points to the potential of a franchise bus model with competition for the market to improve efficiency and outcomes in growing and congested urban areas.**
- **Governance and subsidy reform can further strengthen outcomes by creating the right structures and incentives in the bus market.**

INTRODUCTION: WHY DO BUSES MATTER TO THE EDDINGTON AGENDA?

3.1 The earlier volumes have highlighted the strategic importance of transport to UK's growing and congested urban areas. Some four fifths of all road congestion occurs in urban areas, and this level of congestion is set to rise. Tackling it raises some important policy choices.

3.2 Where congestion is growing, buses can contribute to better use of scarce road capacity and help alleviate peak traffic. Even with road pricing, public transport, including buses, will remain critical where a credible alternative to the car is needed to support labour markets in cities.

3.3 Buses are the most widely used public transport mode in urban areas, providing a flexible form of capacity which can, in the right circumstances, offer a cost effective solution to tackling pinch points on the network. They can also support the delivery of environmental and social objectives, including accessibility.

Buses operate as part of a wider transport network

3.4 There is a lively debate on whether the current bus model in urban areas is fit for purpose to secure desired economic, social and environmental outcomes. A disadvantage buses currently face relative to the car is that roads are effectively free and not priced: individual car owners do not face the true costs of travelling on the roads during peak times.[1]

3.5 By next year public expenditure on buses in England will amount to £2.5 billion per annum (see Figure 3.8). Before consideration is given to future spending on buses, it is important to understand and address any underlying issues with the current bus competition model. Only then will there be an opportunity for buses to become a credible alternative to the car, with value for money secured on bus expenditure, and buses playing a pivotal role in growing and congested urban areas in the future.

3.6 This chapter considers the current and future role of buses purely in urban areas. It does not attempt to examine, or draw any conclusions for, the operation of buses in rural areas. The chapter:

- begins by exploring the historic trend in the bus market and specifically examines the trends in different urban areas over the last 20 years;
- considers what might be driving the observed outcomes – exploring the intrinsic characteristic of the bus market, but also the external factors that influence its operation;
- introduces, and explores, the evidence in relation to the 3C principles: "competition" forces, "coordination" of services and "cooperation" between local authorities and operators, essential for the successful delivery of bus services in urban areas;
- sets out proposals for strengthening competition in the bus market in urban areas, to put in place a model which can be sustained in a world with and without road pricing; and
- highlights how governance and subsidy reform can further strengthen outcomes by creating the right structures and incentives in the bus market.

THE LONG-TERM DECLINE IN THE BUS MARKET AND ITS ROLE IN GROWING AND CONGESTED URBAN AREAS

Bus demand has been in sharp decline since the 1950s

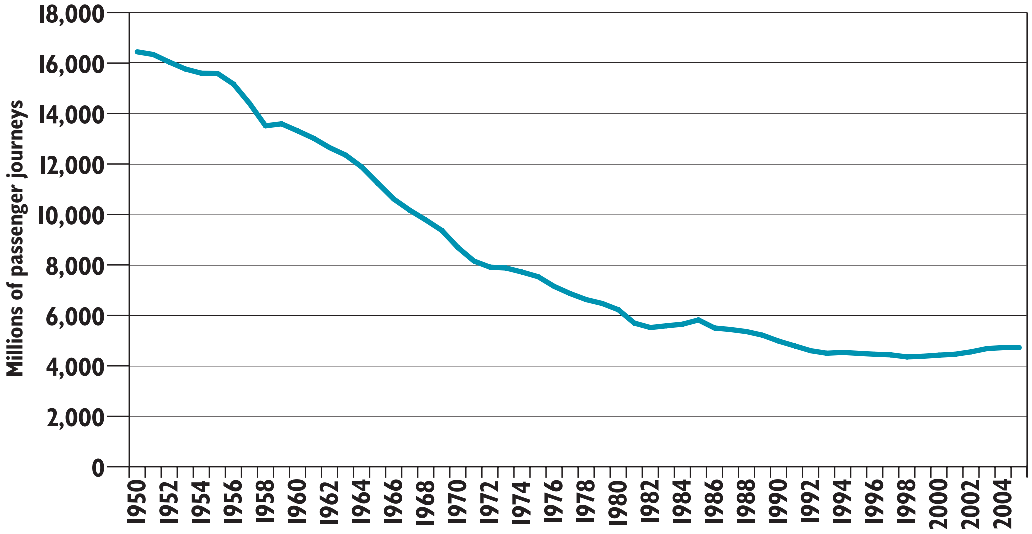
3.7 Over time, wealth creation has fuelled the demand for cars. Car travel[2] in Great Britain doubled in just seven years between 1953 and 1960. It doubled again between 1960 and 1967. By 1990, the distance travelled by car had increased to more than ten times the 1953 figure.

[1] Although clearly congestion and traffic will have an impact on car users' decision to travel during these periods.
[2] Measured in vehicle kilometres.

3.8 The consequential decline in bus patronage[3] is of little surprise. At its peak in the 1950s, there were 16,455 million passenger journeys by bus per annum. By 1971 this figure had halved. By 1999 it had halved again, to approx 4,350 million. The number has picked up in recent years to 4,719 million (see Figure 3.1).

3.9 The bus and coach sector today has approximately one seventh of its market share in 1952, when the industry accounted for some 42 per cent of all travel[4] in Great Britain. This share had fallen to 28 per cent by 1960; by 1973 it had dwindled to 14 per cent. Since 1991 the market share has stabilised at around 6 per cent.[5]

Figure 3.1: Decline in bus patronage in Great Britain since the 1950s peak[a]



[a] Figure comprises passenger journeys from bus, trolleybus and tram. Bus passenger journeys comprise the greater majority.
Source: PSV Annual Inquiry (STATS100).

Widening gap between public transport and motoring costs

3.10 Even in recent decades the bus continues to lose out to the car. Although expanding bus use is not a goal in itself, where urban congestion is growing and road capacity is scarce, buses can make an important contribution to economic growth and environmental objectives.

3.11 The overall cost of motoring has remained at or below its 1980 level in real terms. By contrast, public transport fares have risen in real terms since 1980. In 2004, bus and coach fares were 37 per cent higher than in 1980. Over the same period, average disposable income increased by more than 95 per cent in real terms. Transport by any mode has therefore become more affordable, but with a significantly greater improvement in the affordability of car use than that of public transport, especially buses (see Figure 3.2).

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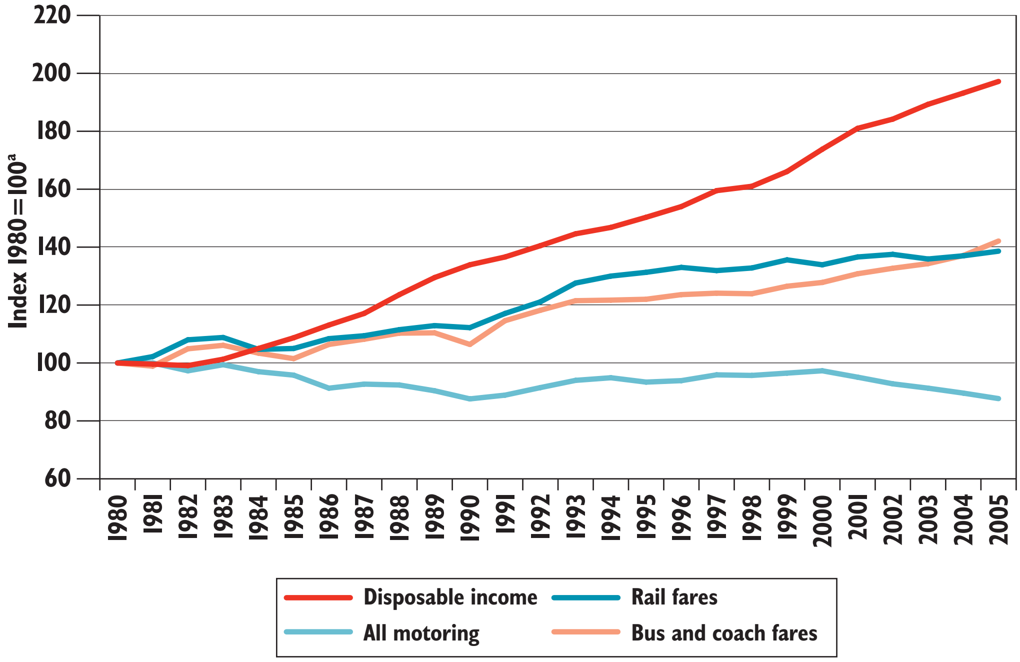
[3] Includes bus, tram and trolleybus.

[4] Measured in passenger kilometres.

[5] Measured in passenger kilometres.

Figure 3.2: Changes in the real cost of transport and income in the UK, 1980-2005



[a]The price indices are taken from the Retail Price Index (RPI), re-based to 1980=100 for convenience.
Source: ONS and DfT.

Buses still remain critical to many users

3.12 Despite these external factors, the bus continues to remain critical. Many cities have been working hard to reverse the trend of downward bus use, as wealth creation has raised the importance of environmental and quality of life factors. There are still some 4.1 billion bus journeys per year in England[6] – equivalent to some 187 bus journeys per household. Although the sector accounts for just 8 per cent of all journeys, the bus remain the most widely used public transport mode, and across the UK the number of bus trips is twice the number of rail plus underground trips.[7]

Supporting labour markets

3.13 Buses are especially important in supporting labour markets in urban areas. The bus continues to play a major role in getting people to and from work – particularly in the UK's larger towns and cities. Over a quarter of workers in cities such as Liverpool, Manchester, Birmingham, Sheffield and Leeds travel by bus.[8] A quarter of all households in England (excluding London) are without access to a car – this figure is two fifths for London; this is a principal driver for continued bus demand.

Tackling road congestion

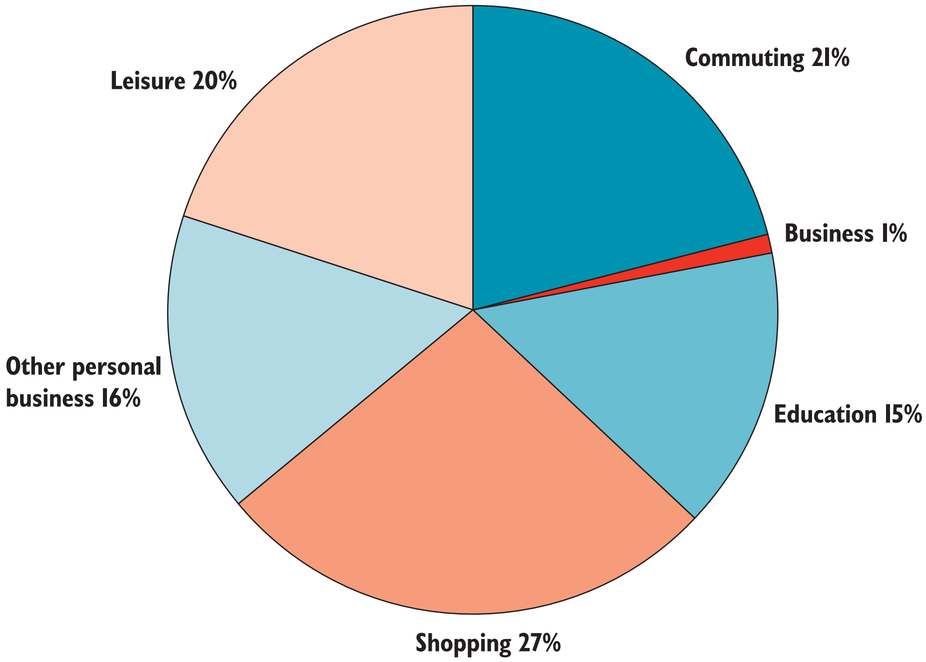
3.14 Buses also have a role to play in tackling road congestion. In the right circumstances buses can be important in encouraging modal shift from the car in congested areas. Although buses typically tend to support non-business trips (see Figure 3.3), without them some of these would, potentially, be made by car. Buses can therefore play a valuable role in attracting leisure and commuter travellers off the road network, freeing up road space and reducing travel time for business and freight traffic (see Figure 3.4).

[6] Measured through bus boardings.

[7] DfT. However, in terms of distance travelled, rail and underground modes account for a slightly larger share than bus and coach travel.

[8] 2001 Census, Office for National Statistics.

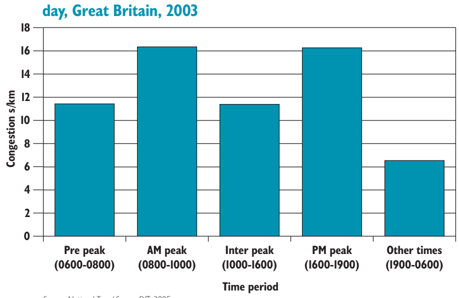
Figure 3.3: Bus trips by purpose in England, 2005 (percentage of total trips)



Source: National Travel Survey, DfT, 2005.

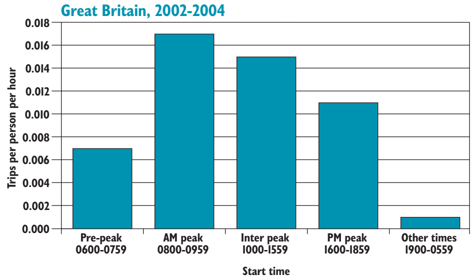
Flexible intervention **3.15** Bus services are a very flexible form of transport capacity that can be deployed relatively swiftly in response to high travel demand and pressures on the road network, as well as on other parts of the transport network (in London, for example, buses are able to take pressure off the tube network, especially in inner London). But, buses are competing not only for users, but also often for scarce road space with cars and freight traffic, which has implications for their overall effectiveness and the circumstances under which they can be usefully deployed.

Figure 3.4(a): Congestion on the road network by time of day, Great Britain, 2003



Source: National Travel Survey, DfT, 2005.

Figure 3.4(b): Weekday trips by local bus by start time, Great Britain, 2002-2004



Source: National Transport Model, DfT.

THE DEREGULATION OF THE UK BUS MARKET

3.16 The bus industry in the UK was largely under government ownership until 1986. At that time, the Government's concerns about the sector's efficiency and responsiveness to passenger needs, along with the increasing level of subsidy needed to support it, led to the deregulation and privatisation of the bus industry outside London.[9] Change occurred in London slightly later – in 1993 the London Bus Ltd subsidiaries were privatised and franchising of bus services was introduced.

3.17 Although two very different bus models were introduced, the principle underpinning change in both markets was the use of competition forces to secure efficiency in the sector and deliver appropriate and comprehensive network coverage with the speed, reliability, quality, and prices that users value.

London: 'off-road' competition for the market

3.18 London's franchising model was introduced on the model of private operators competing to operate in the bus market through short- to medium-term contracts. This can be described as 'off-road' competition. Payment to operators is directly linked to performance, with fares and service routes determined by the Mayor and Transport for London, who also bear any revenue risk.

Other urban areas: 'on-road' competition for the user

3.19 For commercial services outside London, which currently represent 78 per cent of the market,[10] a more deregulated model was introduced whereby bus operators, rather than competing to operate in a particular market, compete directly for customers and determine routes and fares on the basis of profitability i.e. 'on-road' competition. For non-commercial services outside London, which constitute the remainder of the market, the model akin to London operates i.e. 'off-road' competition through tenders. These subsidised services are mostly on routes that the main bus operators in the area find uneconomical to run, either at less popular times or on less profitable routes.

The impact of deregulation

3.20 This section explores some of the outcomes observed in different urban areas following the introduction of competition in the bus market. London has seen a substantial reduction in fares, growth in vehicle mileage and large increases in bus subsidy and patronage. By contrast, in the Passenger Transport Authorities[11] (PTAs), bus subsidy has stayed roughly static while patronage has fallen by over a third in the last 20 years. In other urban areas, bus subsidy has risen fast while patronage has stayed constant, despite reductions in the number of services. In a small subset of urban areas, the market has been expanding with service levels and patronage increasing (e.g. Oxford, Cambridge, York).

[9] The reforms of the mid-1980s combined deregulation (the ability to run bus services anywhere, initially at 42 days notice and then extended to 56 days in 2002) with privatisation of the National Bus Company and Scottish Bus Group subsidiaries. The PTAs and municipal undertakings were reorganised as "arms-length" companies and the majority have since been sold to the private sector.

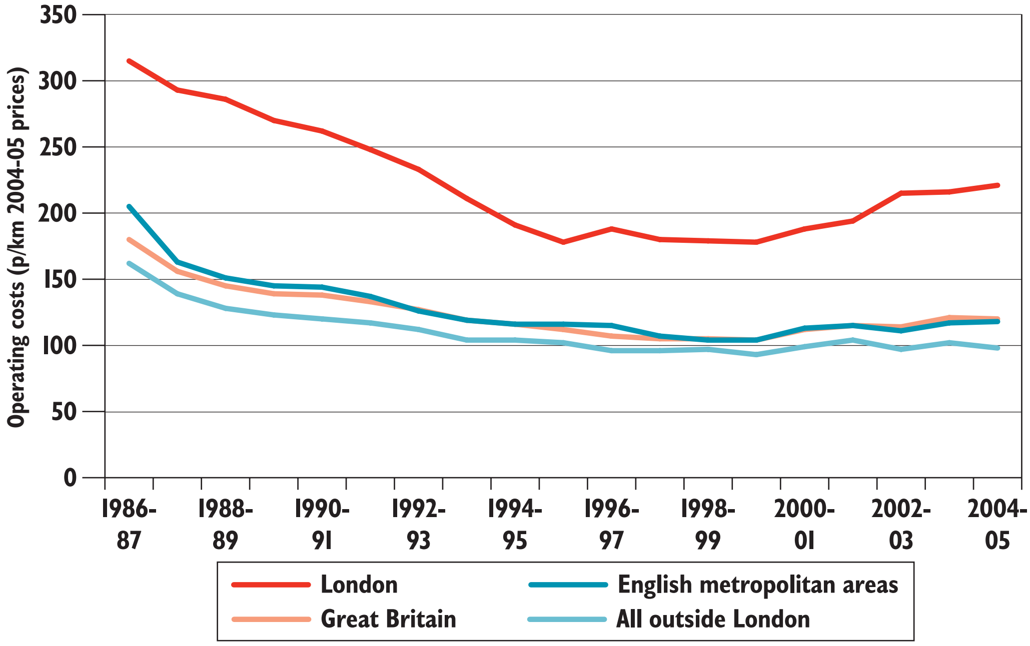
[10] Measured in vehicle kilometres.

[11] PTAs were created following the 1968 Transport Act. There are six in England: Greater Manchester (10 metropolitan authorities); Merseyside (5 metropolitan authorities); South Yorkshire (4 metropolitan authorities); West Yorkshire (5 metropolitan authorities); West Midlands (7 metropolitan authorities); and Tyne & Wear (5 metropolitan authorities). PTAs are made up of councillors from each of the metropolitan authorities within its boundary and are supported by officials in their respective Passenger Transport Executive (PTE).

Operational efficiencies have increased

3.21 The introduction of competition forces in the bus market has achieved a substantial reduction in operating costs. Cost reductions have been experienced in both the franchise market in London, and in deregulated markets in other urban areas.[12] The largest real term reductions in operating costs from 1986-87 to 2004-05 have taken place in Scotland (48 per cent) and the PTA areas (47 per cent) with a 34 per cent reduction in costs in London (see figure 3.5).

Figure 3.5: Bus operating costs in Great Britain, 1986/87-2004/05



Source: PSV Annual Inquiry (STATS100).

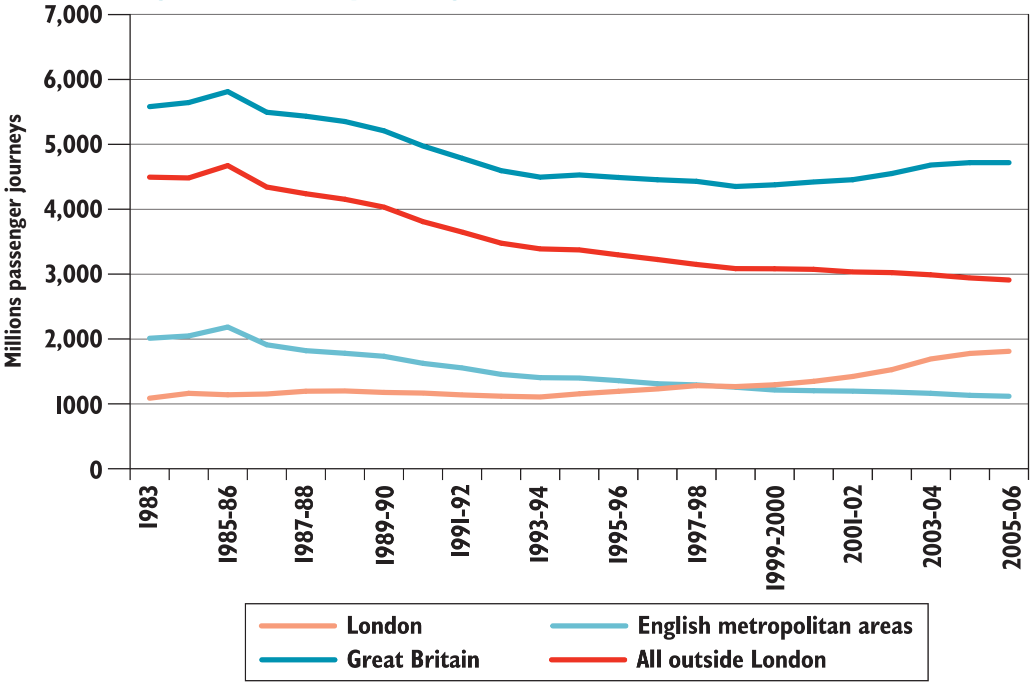
3.22 However, in recent years costs have been rising across the industry. This increase, particularly in London, has been driven by rising costs of wages, as well as insurance, pensions, depot, fuel, rising congestion, and higher quality services. In contrast to costs per kilometre, costs per passenger journey have fallen by 28 per cent in real terms in London since 1985 but have increased by 8 per cent outside London. This difference largely reflects the higher load factors that have been achieved in London.

Patronage has started rising in recent years

3.23 The decline of the bus market has continued since deregulation, albeit more slowly (partly because it has been falling from a much lower base). Overall, passenger numbers in Great Britain have seen a fall of 19 per cent since 1985-86, although recent years have seen an increase: a rise of 8.5 per cent since the lowest point in 1998-99 (driven by London, which now accounts for 38 per cent of the market). While London has seen its market grow by 59 per cent since 1985-86, other areas have suffered major declines in passenger numbers: PTAs by 49 per cent; English shires by 57 per cent; and Scotland by 30% (see Figure 3.6).

[12] For example, Heseltine and Silcock (1990) state that in the early phase of deregulation, two thirds of the fall in unit costs was due to productivity improvements, and the remainder is a mixture of real fuel price falls and falling real wages. See *The Effects of Bus Deregulation on Costs*, Keseltine, P. M. and Silcock, D.T. (1990) Journal of Transport Economics and Policy, Vol 24, No 3, pp283-294.

Figure 3.6: Bus passenger trends in Great Britain, 1983-2005/06

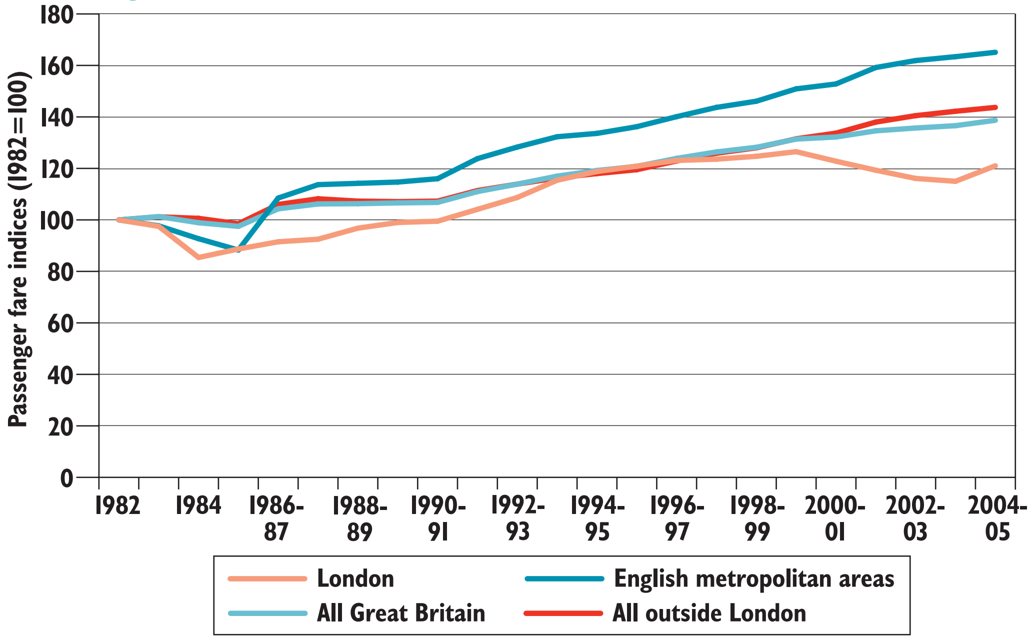


Source: PSV Annual Inquiry (STATS100).

Bus fares have increased 3.24 Over this period bus fares have been rising sharply in real terms (see Figure 3.7). The changes in fares in different areas reflect the level of subsidy pre- and post-deregulation.

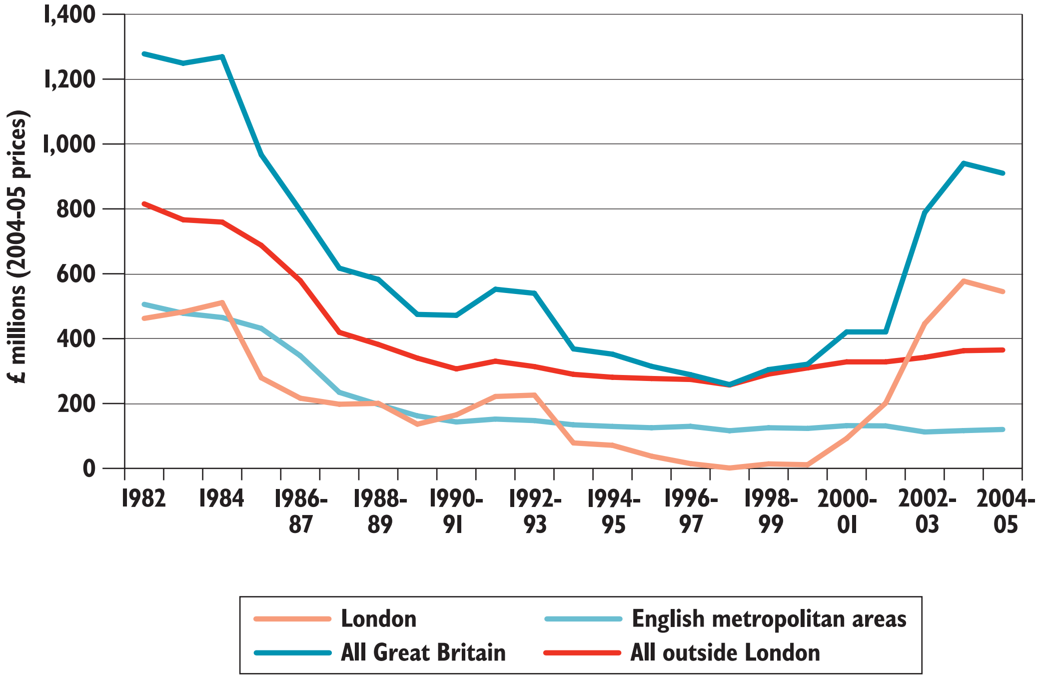
Decrease in bus subsidy 3.25 Following the introduction of competition, and in common with other privatised markets, the balance of funding has shifted towards greater funding by users through fares and away from the general taxpayer through public expenditure and bus subsidy. The latter has however, started to increase in recent years and almost doubled over the last decade (see Figure 3.8).

Figure 3.7: Trends in fares in Great Britain, 1982-2004/05



Source: Bus Fares Survey.

Figure 3.8: Trends in the level of bus and coach subsidy, Great Britain, 1982-2004/05



Source: DCLG and DfT.

3.26 Overall public expenditure on buses is set to rise to some £2.5 billion in 2006-07, largely reflecting expansion of concessionary fares, and growth in expenditure in London (see Figure 3.9).

Figure 3.9: Public expenditure on buses in England, £ million (nominal)

	2003-04	2004-05	2005-06	2006-07
DfT grants to operators (Bus Subsidy Operating Grant)	350	359	380	398
DfT grants to local authorities (mostly rural bus subsidy grant)	74	82	73	73
Local authority spending on secured services	232	232	238	254
London bus support	572	545	634	711
Concessionary fares	448	469	482	830
Capital spend (PTAs, Shires, Metropolitan districts)	229	235	240	246
Total spending on buses in England	**1,905**	**1,922**	**2,047**	**2,512**

Source: DfT.

UNDERSTANDING THE DRIVING FORCES OF THE OUTCOMES OBSERVED

3.27 There are a number of possible explanations why the bus market may not be delivering appropriate and comprehensive network coverage at the quality and prices that bus users value:

- as this chapter has already explored, rising wealth, and the increasing affordability and attractiveness of the car have underpinned the long-term decline of the bus industry. A rising cost base in recent years has also been a critical factor in driving increased fares. Both of these factors bring about service reductions;
- other inherent factors in the sector distort market mechanisms and incentives for delivering the bus services that users value, e.g. the absence of road pricing, bus subsidy and the governance arrangements. Road congestion is not only making bus use less attractive (at least up to a notional 'tipping point'), it is also increasing its cost by reducing efficiency (for example, the same journey takes longer, and more buses and drivers are needed to maintain a given frequency); and
- the current competition framework does not generate the right incentives given the wider characteristics of the bus market and the bus mode.

3.28 This chapter goes on to explore the second and third issues listed above in further detail. It begins by looking at factors that influence demand for bus services before examining the factors that impact on supply.

Understanding the demand for buses

3.29 The characteristics of the bus market directly influence the demand and supply of bus services. The determinants of the demand for buses can be broken down into three broad categories: direct factors influencing the demand for bus services such as journey time and reliability, fares and frequency; broader network factors such as route coverage, integrated timetabling and stability; and factors external to the bus network such as car restraint measures, trends in car ownership and demographic change. Figure 3.10 sets out some of the evidence on the importance of these drivers. This illustrates that while it is difficult to attract bus customers it is very easy to lose them – this is partly because for many, a ready-made alternative, the car, exists.

Figure 3.10: Factors influencing the demand for buses

Direct demand factors[a]

- **Fares:** These are an important determinant of demand. London's maintenance of fare increases below inflation from 2000 until 2004 helped to stimulate nearly 30 per cent of demand growth in that period.[b]
- **Journey times:** The overall speed (time spent in the vehicles but also waiting time for bus) relative to other modes is important.
- **Waiting times:** Waiting times are valued at around two and a half times higher than the time spent on the bus, and measures to reduce these can have a large impact on demand.[c]
- **Service frequency:** Via reductions in waiting time, increases in service frequency can have a large effect on demand. Typically, an increase in frequency from 4 buses an hour to 6 buses an hour could increase demand by 20 per cent.
- **Quality:** Quality factors such as comfort, ride quality, seats, air conditioning etc. are highly valued and are particularly important to encourage mode shift.[a]

Network factors – Many of these will directly impact on demand through the impact on journey times, reliability and quality.

- **Real time information:** Real time information is valued at between 4p and 9p per trip, and where it has been introduced it has increased demand. For instance, on-bus information announcements on the London route 149 are being extended across the network after 90 per cent of passengers claimed it improved their journey.
- **Information, branding and marketing:** Branding and targeted marketing campaigns have coincided with rises in patronage, for example, of 5 per cent a year in Brighton, and of 50 per cent since 1998 on specific routes with bus priority measures in Nottinghamshire.
- **Coverage:** In 2002, 27 per cent of people stated that they did not use the bus because it did not go where they wanted it to.
- **Predictability and reliability:** The predictability of public transport routes was the third most important determinant of quality cited in a large survey of bus users in Leeds in 2004. The reliability of bus services is invariably cited as passengers' most important concern.[d]
- **Interchange:** Improvements to interchange facilities, and to bus facilities in general, providing secure, convenient and accessible interchange, have a large impact on demand. The new bus station at Vauxhall Cross has, for example, seen a rapid rise in passenger numbers.[e]
- **Bus lanes and other bus priority measures:** These lead to reductions in journey time; increased reliability; and the ability to increase frequencies beyond those achievable in mixed traffic. These improvements are important for mode shift, for example a new bus lane in Dublin made the bus 20-25 minutes faster than the same journey by car, leading to an estimated reduction of 8-10,000 fewer cars daily on the road.

External factors impacting on bus demand

- **Demographics:** An ageing population should in theory lead to more demand for buses, but in practice car ownership is increasing for the over-50s group. Population growth in London is one of the reasons for its growth in bus patronage. While in other cities, reduction in inner city population densities will have a negative impact on bus demand.

[a] For details on the importance of different factors see 'The Demand for Public Transport: A practical guide' TRL, 2004.

[b] TfL.

[c] WebTAG 3.5.6.

[d] New Horizons Research into Citizens' Understanding of Journey Quality.

[e] Implications for Appraisal, 2004, awaiting publication, DfT.

- **Car ownership: Rising car ownership is the main external factor that explains the decline in bus patronage. However, levels of driving licence ownership have been falling among 17-20 year olds, but rising for the over-60s. These groups are the main users of buses, and the introduction of free fares for the over-60s may reverse the trend to some extent.[f]**
- **Car limiting measures: These have been crucial to most examples of successful patronage growth and bus partnerships. Car owners' preference for the car compared to the bus is valued at the equivalent of around 20 minute's worth of time or £2 to £3 a trip, irrespective of other costs.[g] Any traffic-demand-management scheme that reduces this difference, such as prioritising road capacity in favour of buses, car parking restrictions or road pricing, will result in an increase in demand for buses. The London Congestion Charge caused a 15 per cent reduction in traffic which helped increase bus speeds by around 5 per cent and deliver a 4 per cent mode shift.[h] Graham and Glaister 2004[i] suggest national road pricing could increase bus use by 7 per cent.**

[f] Transport Trends: 2005 Edition, DfT.
[g] Manchester Metrolink Study 1996, unpublished.
[h] London – Impacts Monitoring, Fourth Annual Report, June 2006.
[i] *Pricing our roads: vision and reality* IEA Volume 1 2004. Graham and Glaister 2004.

Understanding the wider environment in which buses in urban areas operate

3.30 The environment in which buses in urban areas operate is a complicated one. A number of factors distort market signals and incentives that lead to the delivery of appropriate and comprehensive network coverage at the quality and prices that bus users value. This section explores the specific characteristics of the model in operation in urban areas outside London.

Tendered and non tendered services

3.31 As discussed earlier, while in London bus services operate on a purely tendered model, in all other urban areas a mixed model operates with two parallel markets. A large proportion of services are delivered through 'on-road' competition for the consumer. However, the Government intervenes in the market to provide supported services, which are not commercially viable, but which meet social and other objectives. This is delivered through 'off-road' competition for the market through tenders. It leads to a combination of supported and non-supported, tendered and non-tendered bus services in urban areas, which can distort market signals and incentives for investment and responding to the needs of bus users.

Two suppliers: operators and local authorities

3.32 Although operators are responsible for the provision of bus services, the local authority is responsible for the provision of bus infrastructure such as bus stops, bus lanes, and the wider road network. There is, therefore, mutual dependency between the two suppliers: one cannot be successfully delivered without the other. This suggests that both local authorities and operators need to have the incentives and preferences for expanding bus use.

Roads are not priced

3.33 A further factor that distorts market signals in the bus sector is the absence of pricing on the road network. This distorts users' travel choices, and, when combined with the growing affordability of cars, further reduces the attraction of buses. The Government intervenes in the market to at least partially correct for this through subsidies, bus priority measures, and car restraint measures that help tackle road congestion.

THE PRINCIPLES FOR DELIVERING EFFECTIVE BUS SERVICES: COMPETITION, COORDINATION, AND COOPERATION

3.34 Recognising the factors influencing the demand for buses, and the broad environment in which buses operate, this Study's view is that there are three key principles for securing the successful operation of buses in urban areas:

- 'Competition' forces;
- 'Coordination' of services; and
- 'Cooperation' between operators and local authorities

Competition model

3.35 This Study is strongly of the view that competition forces rather than the alternative model of State ownership and control are the appropriate mechanisms for securing successful economic outcomes in urban areas and delivering bus services that users value. Competition forces create on-going incentives for efficiency, and responsiveness of provision to the needs of users. The former has clearly been evident since deregulation, which led to a fall in operating costs in some markets of 50 per cent. There has also been considerable innovation in the bus market following deregulation including improvements in bus fleet, variable bus sizes, out-sourcing of maintenance, smart ticketing and the introduction of part-time working arrangements for employees in the sector.

3.36 The key question is which model of competition, 'on-road' competition for the user or 'off-road' competition for the market, is the best mechanism for securing these outcomes.

Coordination of services

3.37 Buses are an integral part of the transport network. Coordination of bus services, and other modes of transport are essential to delivering the services that users value (as set out in Figure 3.10). As discussed earlier, failure to integrate services, or rapid changes to timetables as operators introduce and remove services creates instability that reduces the attractiveness of bus use. Coordination of services is likely to be even more important in large conurbations where multi-trip journeys may be more common.

Cooperation between operators and local authorities

3.38 It is also clear that cooperation between operators and local authorities matters. Local authorities own the bus infrastructure as well as the wider road network. They therefore have the levers to introduce bus priority and car restraint measures, which impact on the demand and supply of bus services (e.g. through journey time and reliability). In PTA areas, coordination between the PTA and member authorities is essential.

3.39 The competition arguments for securing delivery are robust, well-rehearsed and backed up by evidence across a range of industries. Evidence on the desirability, and level, of coordination and cooperation is more limited. This section goes on to consider what might be the right blend of competition, coordination and cooperation for securing the desired outcome in the bus market in different urban areas. Figure 3.11 highlights the current picture in different urban areas. These have been split into three broad categories:

- A. Urban areas with shrinking bus markets (including PTA areas)
- B. Urban areas with growing bus markets; and
- C. London.

3.40 The section goes on to explore how the current levers of, and incentives for, different partners may be contributing to this.

Figure 3.11: Current model of securing the 3Cs in different urban areas

	A. Urban areas (including PTAs) with shrinking bus markets	B. Urban areas with growing bus markets	C. London
Competition forces	Competition forces through 'on-road' competition: up to 50 operators but two or three dominant players	Mixed situation. Genuine 'on-road' competition tends to be limited, with many areas characterised by a single or handful of operators	Competition is delivered through off-road competition, but tender numbers can be low which may come at a cost[a]
Coordination of services	Limited. Coordination can often suffer through competition – but in some PTAs can occur as a consequence of unwritten understanding between main players	Tend to be one or two main players and secured through partnership agreement with local authority	Strong and formalised through franchise with TfL determining routes and services and integrating with wider transport network
Cooperation between operators and local authorities	Limited. Some areas, particular PTAs may be too large to create effective cooperation through partnerships – multi-lateral arrangements needed	Some areas, usually unitary authorities, secured through informal/voluntary agreements – although often not binding on either party	Secured in franchise through traditional contractual relationship

[a] *Average number of bidders received in London has increased recently from 2.5 to 3 per tender.*

Source: Eddington study.

A. Urban areas (including PTAs) with shrinking bus markets

3.41 A large proportion of urban areas outside London, including the PTA areas, are experiencing shrinking bus markets. Figure 3.12 below illustrates the experience of Greater Manchester and South Yorkshire.

3.42 In some urban areas, switching from bus to other modes, including the car, may be a desirable outcome where it does not impose significant costs to others. This may especially be the case where road congestion is not a problem. However, in growing and congested urban areas, it is clear that buses have an increasing role to play.

Figure 3.12: The operation of buses in the PTAs[a]

Since 1986, PTA areas have experienced falling bus patronage, rising fares and increasing provision of subsidised services. For instance:

- **Greater Manchester: Bus use has declined per head of population by 30.9 per cent between 1987-88 and 2003-04. Over the period 1994-95 to 2002-03, fares have risen about 8 per cent in real terms. A total of 15 per cent of services are now run non-commercially and funded by the PTA. However, there is still considerable demand for buses in the city. The bus accounted for 90 per cent of local public transport journeys in Manchester in 2000.**
- **South Yorkshire: Bus use per head of population has declined by 46.8 per cent between 1987-88 and 2003-04, whilst passenger journeys declined by 53 million, some 33 per cent reduction between 1994-95 and 2004-05. During this period there was a considerable rise in fares, of 13 per cent between 1994-95 and 2002-03, and then of a further 30 per cent in 2004-05. The PTA area has also experienced a 30 per cent decline in commercial kilometres run over the period 2000-01 to 2005-06. At the same time the number of non-commercial kilometres tendered out by the PTA has increased by 106 per cent. 10 per cent of all services are now funded by the PTA.**

[a] For more information see: *The decline in bus services in English PTE areas: the quest for a solution*, NERA, 2006 and *Bus services across the UK*, the Transport Select Committee 11th report of the session, 2005-6.

3.43 In these growing and congested urban areas, the current status of the 3Cs and associated levers at the disposal of the different parties can create perverse incentives. These can lead to outcomes which cannot be sustained in the long run, or which come at a cost i.e. instability and loss of bus passengers to the car (a cost which is particularly high in congested urban areas if there is no road pricing).

Limited levers for bus operators

3.44 Operators have limited levers to control the bus services on offer: the provision of such services is dependent on access to the road network, including through priority bus measures.[13] The demand for bus services is influenced by road pricing (and in the absence of road pricing, by other forms of car restraint measures). But both bus priority and car restraint measures are determined by local authorities and government – not operators.

Limited levers for PTAs

3.45 The situation in PTA areas is complicated further. The PTAs are responsible for local transport planning, including producing a bus strategy, and procuring non-commercial bus services. However, they have no highway, traffic or parking powers and cannot therefore introduce the necessary complementary measures such as demand management or public transport packages. PTAs are dependent on the cooperation of their member authorities to implement necessary bus priority measures. This issue is explored further in Chapter 4.2.

Limited benefits to users

3.46 As a consequence, benefits to users can be limited. Although the theoretical arguments for competition between operators leading to positive outcomes for the bus user are strong, the outcomes observed in practice in many urban areas suggest that there is scope for further improvement.

3.47 That is not to say that competition has not resulted in positive outcomes for some bus users. In Oxford, for example, competition between Stagecoach and Go-Ahead has in part

[13] For example, quality bus corridors.

contributed to the expansion of the market.[14] However, it is very difficult to identify successful growth of bus markets in congested urban areas where partnership and/or car restraint measures are absent.

3.48 Equally there are examples where competition has not secured the expected outcomes. Although some operators have sought to improve services,[15] in general they currently have limited long-term incentives to improve service quality and meet users' needs. Product differentiation on quality is difficult. Users do not have loyalty to an operator (although some have tried to build customer relationships through advanced discount ticketing), nor do they necessarily distinguish between good and bad service providers in the short term – for example, someone waiting for the bus will get on the first bus that arrives.[16] As a result, poor quality buses and services can undermine the overall image and therefore attractiveness of the mode over the longer term.

3.49 Operators seldom engage in direct competition for customers: bus users only genuinely have a choice of service provider on 4 per cent of routes.[17] In PTA areas in particular, the dominant players habitually choose not to compete on another operator's patch.

Wasteful competition

3.50 However, where competition between operators does occur, it sometimes generates the wrong type of competition. Operators have limited incentives to ensure bus services complement other public transport services. In some circumstances, bus operators have been known to compete with other modes of transport, rather than helping to offer a credible alternative to the car.[18] This can lead to a waste of resources where these other modes are also publicly funded.

3.51 It can also lead to frequencies above optimal levels, which may be beneficial to bus users in the short term, but can also create significant road congestion and impact on journey reliability.[19] Bus wars can lead to a bunching of services and timetable instability, which can be very disruptive and drive bus users to shift to other modes of travel. Hence competition for the user in some urban areas can come at a cost to coordination and stability, and impact on the overall transport network.

3.52 A clear merit of the current system is the relative ease and low cost with which operators can register their services.[20] This considerable network flexibility allows operators to experiment with growing routes, and allows incumbents to drop services easily and contract operations that are no longer commercially viable.[21] From a market perspective this level of efficiency may seem a good thing, but from the perspective of the bus user it can result in changing timetables with potential knock-on effects in terms of instability, unreliability, fragmented services and lack of coordination.

[14] There are also factors, including traffic restraint and the growth of the student population that have no doubt also contributed to the growth of the bus market, and that may have enabled the competition to be sustained.

[15] For example, Blazefield (now owned by Transdev) in Yorkshire, and Lancashire and Trent Barton in Nottinghamshire and Derbyshire.

[16] As payment is at the point of consumption, consumers face a zero or low cost of switching bus operators. Although it is considerably higher for those who have single-operator travelcards (and have to pay for other operators' services)

[17] TAS report on Competition in the bus market, 2005, prepared for the Commission for Integrated Transport.

[18] For example, recent evidence in Tyneside where the bus directly competed with the Metro.

[19] For example, when UK North challenged Stagecoach on one route in central Manchester, this resulted in 30 buses per hour at some stops – causing significant road congestion and disruption to the tram.

[20] Operators must register services (routes, timetables etc) with the traffic commissioner giving at least 56 days notice. 56 days notice must also be given of any variation in the particulars or of cancellation of services. There is some discretion for the traffic commissioner to accept shorter notice periods, for example, if a service is being introduced to replace a cancelled one.

[21] In addition there are no realisable incentives for operators to attempt to turn around marginal routes.

Case for strengthened competition

3.53 In summary, while competition forces are prevalent through 'on-road' competition for the user, they may not always deliver the desired outcomes, and can often come at the expense of what bus users value owing to their impact on instability and lack of coordination of services. There is, therefore, a strong case for strengthening competition forces to enhance delivery of efficiencies and successful outcomes in urban areas. It is also clear that current levers and governance arrangements limit the cooperation that may be desirable.

B. Urban areas with growing bus markets

3.54 Many point to growing patronage and improving services in medium-sized urban areas, such as Brighton and Hove, Oxford, Cambridge and York (see Figure 3.13) as an indicator of 'on-road' competition for the user delivering outcomes that bus users value.

Figure 3.13: Urban areas with growing bus markets[a]

Some urban areas are experiencing considerable growth in bus patronage. These tend to be medium-sized areas, and often, although not always, unitary authorities cooperating with one or two major bus operators. In many cases they are historic town centres where car restraint can easily be applied, as residents recognise the value of preserving them. There is usually a wide spread cultural acceptance of the need for alternatives to car transport among the population. For example:

- **York:** Has achieved patronage growth of 50 per cent in the last 5 years. 30 per cent of growth was due to park and ride schemes, where one principal bus operator worked in voluntary partnership with the unitary authority to introduce high-quality services. The historic city centre is naturally unsuited to cars and this has enabled easier introduction of restraint measures such as limited parking.
- **Oxford:** The City of Oxford is a striking example of how congestion can be reduced by a sustained and coherent policy, combining traffic and parking restraint with the promotion of bus use. This has been achieved over a period of more than 30 years through partnership between Oxfordshire County Council, Oxford City Council, bus operators and others. Patronage growth was achieved at a time when it was falling in most other places, e.g. by 80 per cent between 1988 and 2002, and is continuing to grow. Oxford is not a unitary authority, and is a rare example of the local authority maintaining successful partnerships with two competing operators without restraining competition. A strong demand management policy, together with 5 park and ride schemes and a large and growing student population, has promoted an environment where there is room for two major operators, and some smaller ones, to thrive.
- **Brighton and Hove:** Has experienced passenger journey growth of 62 per cent (equivalent to 14 million journeys in total) between 1993 and 2005. A unitary authority with distinct geographical boundaries operates in a voluntary partnership with the single principal bus operator to achieve high-quality services using bus priority lanes, frequent marketing campaigns and real-time information. Brighton and Hove's medium-sized population offers excellent potential for a bus market, with over 50 per cent of workers travelling less than 5 km to work. 97 per cent of services are commercially run.[b]

[a] *Bus services across the UK*, the Transport Select Committee 11th report of the session, 2005-6.

[b] Evidence provided to the Eddington Transport Study by Brighton and Hove Bus and Coach Company, and Brighton and Hove City Council, 2006.

3.55 Some of the main factors contributing to the outcomes observed in these urban areas are:

- Scale of market: these areas tend to be medium-sized towns often characterised by a unitary authority, e.g. Brighton, York, Telford, although not always, for example, Oxford and Cambridge;
- Monopoly in provision: The operator predominantly enjoys some form of local monopoly in provision: where one or possibly two operators can be sustained in servicing an area of this size. Operators are rarely in direct competition with each other;[22]
- Partnership arrangements: The existence of voluntary partnerships allows cooperation between the operator and the local authority, possibly because the smaller number of players appears beneficial to both parties;
- Captive market: The existence of a captive bus market for consumers is common, with some form of bus priority and car restraint (parking fees) in operation; and
- Preference to prioritise bus use to tackle congestion: Councils that have the incentive and preference to introduce car restraint measures and promote bus use to tackle congestion.

3.56 Although coordination and cooperation is delivered through partnership working, it is less clear what role competition forces are playing in securing the market outcomes characteristic of these urban areas. For example, these arrangements do not preclude new operators entering the market and providing bus services in these areas, but they can make it difficult.

C. London bus market

3.57 The London model differs greatly from other urban areas in that competition forces are secured through 'off-road' competition for the market in the form of franchising. See Figure 3.14 below. Patronage in London has increased rapidly in recent years, but this has also been accompanied by a large rise in subsidy.

3.58 Coordination is secured through tendered contracts with TfL, which determines the routes; and cooperation is secured through incentives and levers for both TfL and the bus operator to improve the provision and quality of services.

[22] In Oxford, the two dominant operators, subsidiaries of Go-Ahead and Stagecoach respectively do run a number of competing services. There are some issues about non-exchangeability of tickets.

Figure 3.14: The London franchise model and the incentives it creates[a]

- **Over 700 bus routes are in operation in London with over four fifths of the market supplied by 5 key players. The number of tenders is often limited, although the average has increased from 2.5 in 2001 to 3 per route tendered. The key point however, is that there is genuine, effective and sufficiently periodic competition.[b]**
- **TfL introduced net contracts in the mid-1990s. Under this model, bus operators bear the revenue risk. This resulted in operators considerably raising risk premiums to cover revenue losses beyond their control, e.g. due to roadworks. Operators also became averse to network changes such as route alterations which could damage patronage (even if only in the short term).**
- **Gross contracts were re-introduced in the late 1990s as an interim measure. Under this model, TfL bore the revenue risk. However, this model removed bus operators' incentives to increase revenue, hence service quality declined further. Rising costs saw operators' returns reduced and some pulled out of the market altogether.**
- **In 2001, TfL moved to quality incentive contracts, where routes are tendered on a gross basis but include a bonus/penalty mechanism linked to quality factors. Under this model, the operator risk is reduced, whilst providing an incentive to increase service quality. Contracts last for 5 years, with the potential for a 2-year extension for good performance. These contracts have resulted in significant improvements in performance e.g. the excess waiting time borne by bus passengers at bus stops has fallen from 2.2 minutes in 2000-01 to 1.1 minutes in 2005-06.**

[a] For more information see: *Value added? The Transport Committee's assessment of whether the bus contracts issued by London buses represent value for money*, London Assembly Transport Committee, March 2006
[b] The bus market is characterised by a good second hand market: barriers to entry are low, overheads and capital investment are low. It is important to ensure that the procurement process continues to foster genuine competition.

IMPLICATIONS FOR THE COMPETITION MODEL THAT MIGHT BE SUITABLE FOR BUSES OPERATING IN GROWING AND CONGESTED URBAN AREAS

The market failures in the bus market

3.59 In exploring the type of competition model that may be appropriate for buses, it is useful to consider whether these might be influenced by the size and presence of market failures in the sector.

3.60 The UK bus market consists of a handful of big operators, approximately 1,500 small operators and very few medium-sized operators.[23] This aggregate picture is replicated at the urban level, where the number of operators that can be sustained appears to be limited: 2-3 players tend to dominate in any one area with many other smaller operators working on the periphery. This market outcome may indicate that too many operators can result in inefficiencies and cannot be sustained for long periods of time, pointing to a weak form of economies of scale in provision.

[23] The majority of companies are owned by five large operating groups who also have extensive rail and overseas interests. A number of larger independent companies have been taken over in the last 3 years, either by one of the five large operating groups or by an overseas group. Nevertheless, a number of independent, or council-owned, companies with around 50-150 buses do still remain in business, some of them providing a mixture of coach and bus services.

3.61 In common with other transport modes, the bus market is characterised by the presence of externalities. In particular, additional bus services can generate additional bus passengers, resulting in higher frequencies and reduced travel time for all travellers.[24] Such benefits to bus users are not reflected in the decisions made by the operators and hence 'on-road' competition for the user could lead to under provision of services in some areas.

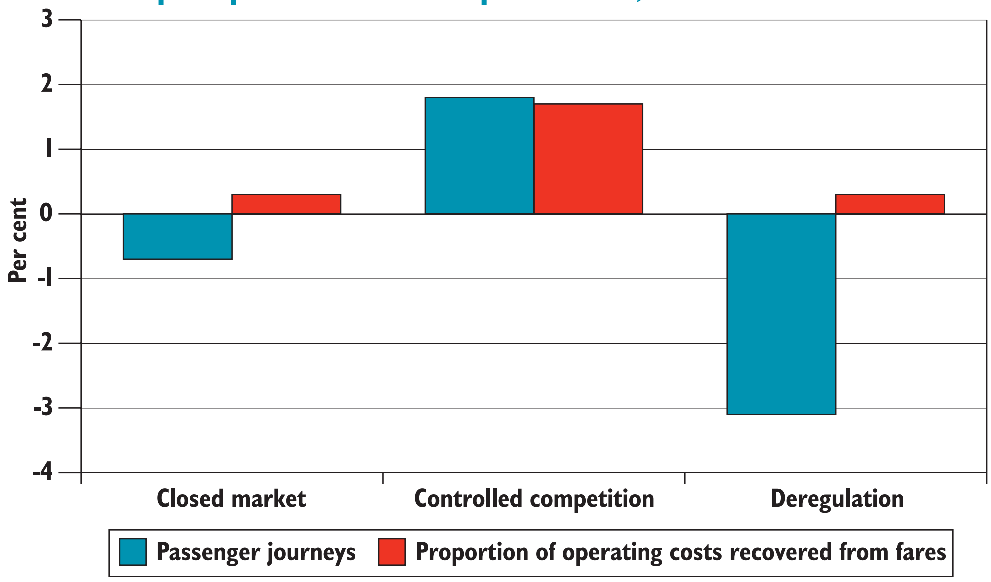
Competition for the user may not work

3.62 More fundamental to the argument on the most suitable competition model for the bus market are the market failures created as a result of 'on-road' competition for the user. In particular, the coordination and cooperation that is necessary to prevent instability and successfully deliver bus services in growing and congested urban areas can, at times, sit uncomfortably with 'on-road' competition for the user.[25]

Evidence from models in operation internationally

3.63 In practice, although it is difficult to disentangle the contribution made by the competition framework to delivering services that users value, the European experience of public transport in cities suggests that on the whole competition for the market delivers more growth in the market (measured as passenger journeys) and efficiencies (indicated by operating costs covered by fares), rather than competition for the user.[26] See Figure 3.15.

Figure 3.15: Effect of different regulatory frameworks in public transport provision in European cities, 1991-2001



Source: Data from Study of good practice in contracts for public passenger transport, Colin Buchanan and Partners for EUDGTREN.

But the London package may not be directly replicable

3.64 However, it would be a mistake to conclude from (i) international evidence indicating a relationship between 'off-road' competition for the market and the expansion of the bus market, and (ii) UK evidence that 'on-road' competition for the consumer is not reversing the decline in bus patronage in congested urban areas, that the London package is the answer for all urban areas.

[24] This is known in the literature as the Mohring effect. See Mohring, H. (1972), *Optimization and Scale Economies in Urban Bus Transportation*, American Economic Review, 591-604.

[25] And as a consequence the private car alternative is often more of a 'competitor' than other bus operators.

[26] However, these results should be viewed with caution: it is not clear what other factors including level of subsidy and car restraint are influencing the outcomes observed.

3.65 There are factors unique to London that may mean that the model is not directly applicable elsewhere. This includes the size of the London economy, and the existence of measures to limit the use of the road network such as: the London congestion charge, limited and high charges for car parking, and low car ownership (approximately four-fifths of the level elsewhere in England). London has also observed constraints on alternative public transport modes (for example, parts of the tube network).

3.66 However, other factors are less unique to London. High frequencies of bus services, improvements in vehicle quality and reliability, and low fares, for example, are not intrinsically unique to London, though they do require high levels of and appear to indicate large levels of subsidy.

3.67 Furthermore, governance arrangements in London are very different to those currently in place in other urban areas. In London, the Mayor has direct responsibility for, and powers to innovate and improve, bus services, alongside the wider transport strategy for the city. Outside London, local authorities/PTAs only have direct responsibility for the bus services they subsidise and the Highways Agency has responsibility for the strategic road network. See Figure 3.16.

Figure 3.16: London and other urban areas: difference in governance and bus models

	London	Other urban areas
Decision making	TfL has direct responsibility for bus services in London.	Local authorities have direct responsibility for 20 per cent of the bus services they subsidise.
Control over transport network	TfL/Mayor has direct powers to innovate, improve bus services and deliver an integrated transport strategy, including the introduction of the London Congestion Charge.	Local authorities/Passenger Transport Authorities do not control the highway network, districts do, therefore they are unable to implement bus priority schemes or demand management measures such as road pricing.
Fare setting	Set by Mayor.	Operators set fares in response to commercial incentives.
Scheduling services	TfL determines the services that will operate.	Operators choose how and where to run services on the basis of profitability.
Accountability	Operators are accountable to TfL on the quality of services.	Operators are not formally accountable for reliability and punctuality of their services.

PROPOSALS FOR REFORM: INJECTING COMPETITION INTO THE BUS MARKET AND SECURING STRUCTURES AND INCENTIVES FOR DELIVERY

3.68 The evidence presented above shows that different combinations of the 3Cs – 'competition' forces, 'coordination' between operators and 'cooperation' between local authorities and operators exist in different urban areas, with varying degrees of success in securing successful outcomes for users. While there are some indications that 'on-road' competition for the user can, in the right circumstances, deliver improved services that bus users value, in practice such examples are rare, and more often the model can generate perverse outcomes, or lead to a significant cost in terms of network instability and continued congestion on the road network.

3.69 As the previous section set out, some useful indicators can help identify the right competition model for buses in urban areas, namely:

(i) understanding the extent to which competition forces are driving improvements in service levels in London and some of the medium-sized market towns, whilst limiting improvements in other areas, particularly PTAs;

(ii) whether competition theory and the presence of market failures can offer any guidance; and

(iii) international evidence on the outcomes of different competition models.

3.70 Overall, the evidence explored indicates that competition for the market through franchising has the potential to deliver improved outcomes in urban areas, if accompanied successfully with coordination of services and cooperation between operators and local authorities. However, in practice, the right blend of the 3Cs will depend on the characteristics of the urban area.

3.71 This Study's view is therefore that there could be a range of competition models that can help deliver bus services that users value. The appropriate model is likely to differ depending on the geographic size and economic and social characteristics of the urban area. Local authorities need to choose the option that allows them to secure best value for public expenditure while ensuring the model delivers in the public interest. Doing so means demonstrating that the competition model, combined with coordination and collaboration, works to deliver appropriate and comprehensive network coverage at the quality and prices that bus users value, and help to secure broader economic and social outcomes.

Policy options

3.72 There are three broad options that urban areas might consider adopting:

(I) the current model of direct competition for the consumer ('on-road' competition);

(II) partnership working between local authorities and operators of key services and routes, but with some direct competition for the consumer from new entrants to ensure on-going contestability (a mix of 'on-road' and 'off-road' competition); and

(III) franchise approach with competition for the market rather than the consumer, and the absence of any direct competition for the consumer, particularly where the risk of destabilisation and value for money benefits are high ('off-road' competition).

3.73 Each of these models is explored briefly below.

(I) Current model of 'on-road' competition for the user

3.74 This approach assumes that bus services that users value are best delivered through bus operators directly competing for the consumer. However, the evidence presented in this chapter suggests that this form of competition can, at times, sit uncomfortably with the coordination and cooperation which – given the wider characteristics of the bus sector, and their existence as part of an integrated transport network – are equally important for bus delivery.

3.75 Where this approach is chosen by urban areas, the goal must be to ensure that competition forces work effectively to deliver services that bus users value, rather than creating perverse incentives and consequentially disbenefits for users through inefficiencies and wasteful competition.

3.76 A robust regulatory framework is essential to ensure that competition forces enhance (and do not prevent), the delivery of efficiencies and successful outcomes in urban areas. For example, some form of standard setting on the circumstances and conditions under which bus operators can engage in the market may help provide coordination and stability.

(II) Partnership approach: mix of 'off-road' competition and 'on-road' competition

3.77 Bus success stories, such as Oxford, York and Brighton and Hove have taken place in urban areas where operators have worked in partnership with local authorities, often enjoying a local monopoly situation, and the willingness of local authorities to deliver necessary car restraint, as well as bus priority measures. However, these partnerships are not legally binding, and care must be taken to ensure that local market power is not institutionalised through voluntary partnerships.

3.78 Critically, it is essential for there to be contestability at both the stage of partnership formulation, and through on-going direct competition for users from new operators. Partnership models should be designed such that competition forces influence with which operators the authority engages in partnerships, and direct competition between operators means these partnerships are (i) regularly contested, and (ii) deliver positive rather than wasteful competition (which can be destabilising).

3.79 Effective bus market regulation is key. Local authorities also need to be able to benchmark the performance of partnerships against the cost and service qualities being offered in other areas under other competition models.

(III) Franchise model – competition for the market

3.80 A move to franchising bus services would secure the necessary coordination and collaboration between authorities and operators, whilst shifting to 'off-road' competition for the market rather than direct 'on-road' competition for the consumer.[27]

[27] It should be noted that all, or virtually all, experience of setting up a franchising system has been as a replacement of a public sector monopoly. All competitors in those circumstances were on a level playing field, and the public authority presumably provided them with identical market information. These conditions could not be replicated where the pre-existing situation is of dominant private sector incumbents with market information that is commercially confidential and not to be shared with others. There will also be other barriers to entry such as ownership of depots and access to vehicles, which may need proactive fostering of entry by local authorities to create effective competition. TfL has needed to be proactive to create and maintain a competitive market in London.

3.81 The evidence presented in this chapter suggests that such a model is likely to be a priority in growing and congested urban areas where there is need to tackle urban congestion, and to deliver a bus model that can work in the presence of road pricing. Furthermore, prior to road pricing, some form of car restraint policies in these areas is likely to be important alongside bus priority measures.

3.82 International examples and London's experience indicate that a number of factors need to be considered when establishing a franchise model, to ensure that these 3Cs work effectively. This means locking in operator incentives to innovate and grow the market while introducing new incentives and levers for local authorities to expand the bus market where this meets the overall economic goal in the urban area. See Figure 3.17 below.

3.83 This model should only be pursued where (i) it offers good value for money (ii) competition forces continue to work to deliver efficiencies and improvements in bus services for passengers.

Figure 3.17: Securing effective franchising – what factors need to be considered?[a]

Route or area tendering: Franchises can be offered for a series of routes e.g. London and Copenhagen, or for a defined area e.g. Lyon and Adelaide. Area tendering allows operators to develop services within a set boundary; this can aid integration within the area but makes inter-area services harder to coordinate; where areas are large they may also prove a barrier to entry, reducing bidders to just a few large companies. Route franchising enables clusters of linked routes to be tendered. This provides greater flexibility of service provision and opens the market to a wider range of bidders, whilst big firms can still increase efficiencies by bidding for multiple groups of routes.

Determination of routes: Both tendering options need to consider whether the power to determine services lies with the local authority or the operators, as each will have different knowledge and expertise in this regard. Area tendering offers greater potential for operator determination, whereas route tendering favours local authority decisions. However, as London and Adelaide demonstrate, both models can incorporate flexibility, with negotiation processes that encourage both partners to cooperate to ensure an innovative network in the public interest. This can allow an optimal network to be determined, for example, by removing any 'over-bussing' on certain routes.

Gross or net contracts: Franchises can employ either net contracts, where the revenue risk is borne by the operator, or gross contracts, where it is borne by the authority. Net contracts mean that operators are automatically penalised for poor performance by lower revenue and this may dissuade smaller operators. Also, due to the nature of bus demand, operators can still make profits whilst performing poorly by cutting quality, so there is less incentive to increase revenue through increasing patronage, which can mean that consumers suffer. Gross contracts, however, do not incentivise the operator to increase revenues by expanding markets, as their only mechanism for increasing profits is to reduce operating costs.

Quality factors: To ensure that franchises incentivise operators to both reduce costs and increase revenue from patronage, many authorities build quality factors into their contracts, ensuring that operators have a stake in improving services. In London, for instance, gross contracts contain provision for financial penalties/rewards for operators against reliability targets.

Length of contract: A sensible contract length needs to be considered when tendering. Short contracts may dissuade operators from committing investment, whereas overlong contracts may reduce competitive pressures on the incumbent. One option for ensuring a suitable length of contract might be to offer extensions after a set expiry period, if operators have satisfied a range of quality criteria.

Determination of fares: Fares can be set by the operator, local authorities or a combination of the two. If set by the operator, fares may exceed socially optimal levels which would discourage considerable patronage growth and social inclusion; if set by local authorities, fares may be too low to offer reasonable cost-recovery and would rule out price competition on the network; but, local authorities are better able to introduce integrated and electronic ticketing systems. Some countries, like Norway, employ a combination of the two, with authorities setting a maximum fare structure within which operators are free to determine optimal levels at any particular time.

[a] For more information see: *Models for the provision, regulation and integration of public transport services*, NERA and TIS.PT, 2001 and *Value added? The Transport Committee's assessment of whether the bus contracts issued by London buses represent value for money*, London Assembly Transport Committee, March 2006.

Effective regulation

3.84 Irrespective of the model chosen, it is important to ensure that the 3C principles – competition, coordination and cooperation – that are necessary for the successful operation of buses in urban areas are retained. The case for effective regulation of the sector to ensure that competition incentives continue to deliver in the public interest is strong and undisputed. Strengthening the case for competition should not come at the expense of incentives for the operator to reduce operating costs and increase innovation (this has been the real advantage since the shift away from state control).

Reforming governance arrangements can lead to a more effective outcome

3.85 This Study's view is that improving competition forces, together with coordination and cooperation can lead to more effective delivery of bus services in urban areas. This could be further enhanced through governance reform to give the sub-national bodies responsible greater levers and incentives to secure bus services as part of an overall transport strategy for the area. Under the current structure, the split governance and funding arrangements between local authorities and PTAs, and between districts and counties, do not always allow sensible integrated planning of transport in urban areas.

3.86 The current allocation of powers can create a number of tensions or constraints to providing a successful bus market. As Chapter 4.2, on sub-national decision-making has explored, there are concerns about whether capacity, funding and powers are aligned. This is especially true in two-tier authorities where the districts are in charge of subsidising individual travel (concessionary fares), whilst the counties are responsible for securing the overall bus network, including subsidising non-commercial services. The problem is especially acute for PTAs, which have no highway, traffic or parking powers.

Review subsidy

3.87 Possible competition reform and changes to governance also provide an opportunity to look at bus subsidy and consider how it can better be targeted to deliver the bus services users value.[28] In particular, it is not clear that the current system of funding to operators (a system of fuel duty rebate based on vehicle kilometres) creates the right incentives to support the priorities this Study has identified for buses in urban areas. First of all, it sits oddly with the Government's environmental objectives by providing little incentive for fuel efficiency; secondly, it offers few incentives for operators to improve services and expand patronage while limiting bus congestion on the road network. There are therefore clear merits to more effective targeting of existing bus subsidy.

3.88 It is not immediately evident that strengthened competition in the bus sector to enhance the delivery of efficiencies and successful outcomes in urban areas needs to be accompanied by additional public expenditure. However, it is important to ensure that any spending continues to deliver value for money.

3.89 It is clear, that reforming and better targeting of existing bus subsidy can help deliver improved outcomes. In addition, devolving bus expenditure to the appropriate sub-national body can create the financial capacity for such bodies to negotiate outcomes with bus operators on the basis of local circumstances, as well as providing fiscal incentives for securing sustained public expenditure on buses in the long term. Such devolution could be particularly desirable in areas that choose to introduce the franchise bus model.

[28] Evidence from New Zealand and Norway shows that where bus subsidy is better targeted it can deliver modal shift and reduce congestion and thereby contributing to GDP.

CONCLUSIONS

3.90 A large proportion of urban areas outside London, including PTAs, are experiencing shrinking bus markets. In some urban areas, switching away from bus to other modes, including the car, may be desirable where it does not impose significant costs to others – particularly where road congestion is not a problem. However, in growing and congested urban areas, it is clear that buses have an increasing role to play. Buses can provide a flexible form of capacity suitable to many urban traffic flows and can contribute to environmental and accessibility objectives. Road pricing will also place a premium on effective public transport markets in urban areas.

3.91 The urban bus market as it has developed in the UK since deregulation has not been truly contestable across the piece. Although patronage overall has stabilised in recent years, fares have been rising and service levels declining, whilst public expenditure on buses continues to grow.

3.92 Securing the effective operation of buses in urban areas to tackle congestion requires some tough important policy choices. Government, local authorities – PTAs, unitary and two-tier councils – and bus operators all need to play their part and respond to this challenge. This includes, where appropriate: mechanisms for strengthening competition; decisions on bus investment by local authorities and bus operators; and willingness at the sub-national level to implement car restraint measures in the short-term, and road pricing in the long-term.

3.93 Getting this right has clear benefits: supporting the growth of urban areas; securing environmental and social benefits, including accessibility; and sustained long term investment in transport in urban areas.

3.94 This chapter argues that ‘competition’ forces, ‘coordination’ of services and ‘cooperation’ between operators and local authorities are the essential building blocks to successful delivery of bus services and successful outcomes in urban areas.

3.95 There are three broad options urban areas might adopt to deliver bus services: (i) current model of competition for the consumer; (ii) partnership working with some limited competition for the consumer; and (iii) franchise model with competition for the market. However, whichever competition model is chosen, the underlying principle of employing competitive forces to secure the effective operation of buses must be retained. There is therefore a strong case for effective regulation of the sector to ensure that competition operates in the public interest.

3.96 It is not clear that any one option is necessarily superior or best suited to application across all urban areas at any one time. But it is clear that the current position in many urban areas can be improved. In particular, the evidence points to the potential of the franchise bus model to improve efficiencies and outcomes in growing and congested urban areas. However, this approach should only be adopted if it can be demonstrated to lead to a better service and deliver value for money. Adequate capacity within the sub-national local body to deliver this change will also be essential. Equally, any change should be phased to minimise instability in the bus market.

3.97 Governance and subsidy reform can further enhance delivery by creating the right incentives in the bus market. There is a strong case for targeting existing bus subsidy more effectively.

RECOMMENDATIONS

Recommendation 5(b)

To strengthen competition in the bus sector to support the economic success of growing and congested urban areas:

(i) Deliver effective regulation of the bus sector to ensure competition forces can be harnessed to improve efficiencies and successful outcomes in urban areas.

(ii) Legislate to allow sub-national bodies the option of introducing franchising of bus services, where the following pre-requisites can be demonstrated: the change offers good value for money; competition forces continue to deliver efficiencies and improvements in bus services for passengers; and the sub-national body has the adequate capability and resources to make this model work.

(iii) To strengthen the successful outcomes from a franchise approach by taking forward recommendation 5(a) by, in particular: aligning highways, traffic and bus powers in the appropriate sub-national body; and for those areas, reforming and devolving bus subsidy to allow effective targeting of spending and secure higher value for money.