

## **Submission to IPART in response to the Draft Report 'Sydney Taxi Fares to apply and new licences to be released from July 2015, December 2014 by Dr. David Cousins, Adjunct Professor Monash University Centre for Regulatory Studies.**

Thank you for the opportunity to comment on the draft report. You will be aware of previous submissions I have made to IPART on earlier taxi fare and licensing reviews and also my involvement as a Commissioner with the Victorian Taxi Industry Inquiry from 2011-2012. More recently, I prepared (with Professor Fels) a report for the Western Australian Royal Automobile Club on taxi industry reform issues<sup>1</sup>. The key issue in all these reviews has been the restrictions on licence numbers and the distortions created by these restrictions. These distortions include excessive pricing, driver exploitation and restrictions to competition, both within the taxi industry and from substitute services.

Whilst IPART has taken some important steps toward taxi industry regulatory reform, these steps have been quite modest. Even these moves have not received the full support they have deserved from the NSW Government, which has not fully adopted IPART's recommendations.

The current system is a public policy scandal. There are at best only very weak arguments to support restrictions on licence numbers and there have been many calls for their reform over past decades. These restrictions are opposed by the great majority of serious economic commentators. Competition specialists have also called for their reform, including the Panel conducting the most recent review of National Competition Policy<sup>2</sup>. The restrictions are highly inequitable in their impacts, particularly imposing costs on low income consumers and disabled consumers. The beneficiaries are a relatively small number of licence holders who have continued to lobby and capture governments to ensure continuation of the restrictions.

IPART is proposing that maximum taxi fares for Sydney not be changed for 2015-16 and that there be no net increase in the number of licences on issue. A number of other recommendations are made on more specific matters the most important of which is that there ought to be a review of the regulation affecting point to point transport services.

My specific comments relate to the basis on which IPART's draft fare and licensing recommendations have been made; the transition path chosen by IPART; the proposal for a review of regulation affecting all point to point services; and the assessment of industry performance.

### **1 Basis on which the draft fare and licensing recommendations have been made**

IPART has in recent reviews moved away from the approach of allowing fares to rise in line with a Taxi Cost Index, and it has also removed the circularity associated with allowing licence lease costs to be included in cost escalation. I have previously argued also that demand factors should be

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<sup>1</sup> Available at: <http://rac.com.au/cs/groups/public/documents/internetcontent/racstg058159.pdf>

<sup>2</sup> Australia, Competition Policy Review, Draft Report, September 2014, pp. 137-139.

considered along with supply factors in determining maximum fares<sup>3</sup>. It is pleasing that IPART has recognised in its draft report the need to do this. There is little logic in allowing industry prices to rise at a time when all the indicators suggest demand is falling. Indeed in a competitive industry, we would expect prices to fall.<sup>4</sup>

IPART's recommendations have been determined within a five year time horizon which sees real licence lease prices declining by 25%. The 25% figure was originally suggested as not being unreasonable taking into account the interests of existing licence holders. The terms of reference for the maximum fare review, however, emphasise customer impacts and the need for greater efficiency. This suggests IPART should aim to remove entirely from maximum fares the economic rent created by any unwarranted restriction on licence numbers. The unreasonable impact issue is just one of the factors IPART needs to consider in relation to the issuing of new licences under its terms of reference.

The introduction of smart phone applications and new technology providers raises questions about the sustainability of existing regulatory arrangements and provides further rationale for immediate reform. IPART, however, seems to want to extend the period of regulatory adjustment as a result of the emergence of this new competition.

Overall, it is suggested that IPART should consider a deeper and speedier adjustment to eliminating the economic rents involved.

IPART has in a more general context argued strongly in favour of setting efficient prices rather than building into prices implicit subsidies for particular groups in the community<sup>5</sup>. Where Community Service Obligations are imposed, IPART has suggested that these be directly funded by the Government. Whilst the context is slightly different, the principle could also be considered to apply in this context where taxis compete, at least potentially, with other point to point service providers. If governments want to maintain the implicit subsidies given to licence holders under the restricted licensing system, the costs of this should be clearly identified and funded directly by these governments. This would bring more to the fore questions concerning possible compensation for costs incurred as a result of reforms being implemented.

IPART has defended the current approach of issuing licences through tender arrangements. However, these arrangements are unnecessarily complex, indirect and imperfect in achieving a matching of supply and demand. This approach requires an administrative decision to be made about the number of licences to issue. Past experience suggests that it is very difficult to determine the right number in this regard, and governments frequently buckle to the political pressure applied by representatives of existing licence holders to limit new licence numbers. A price-based approach<sup>6</sup> has significant advantages in this regard. The Government could determine a new licence lease price

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<sup>3</sup> David Cousins Submission to IPART in response to Issues Paper October 2013, Review of maximum taxi fares and review of annual Sydney taxi licences from July 2014.

<sup>4</sup> Where supply is perfectly elastic no reduction in prices would be expected to result from a reduction in demand.

<sup>5</sup> IPART, Opportunities for Further Reform, Submission to Competition Policy Review Issues Paper, June 2014.

<sup>6</sup> Where the Government determines the price at which it is prepared to lease licences and makes licences available to all comers who are prepared to pay this price and satisfy appropriate minimum standards.

which could then be built into fare setting. Most importantly, industry participants could then be left to make their own decisions as to whether to obtain a licence or not. Under the Regulations, it would seem possible for a system like this to be implemented.

## **2 The transition path**

IPART has modelled the impact of various combinations of fare adjustment and licence number growth which accommodate a 25% real licence lease price reduction within a five year time period. As has been previously suggested, there is ample evidence to suggest that maximum taxi fares in Sydney have been set at too high a level. This is suggested by fare comparisons with other jurisdictions, though these comparisons are of reduced value given the distortions also evident in other jurisdictions; by the survey evidence provided by Taverner Research; and by declining taxi demand. It is very difficult to accept IPART's suggestion that falling demand is not related to existing fare setting<sup>7</sup>. In these circumstances a move to reduce nominal fares seems appropriate. Reducing fares will have the beneficial effect of increasing demand and vehicle utilisation.

IPART has proposed that there be no growth in licence numbers in the coming year. Whilst this may be consistent with its maximum fare recommendation and the overall 25% real licence lease price reduction objective, it is inappropriate to make such a recommendation in the knowledge that it will increase waiting times for customers. Regulation should facilitate improved industry performance, not the opposite. Waiting times are, as IPART itself suggests, an indicator of the adequacy of supply.

## **3 Review of regulation affecting point to point services**

IPART has proposed that a more comprehensive review of the regulation of point to point services be conducted given the perceived growth of substitute services for taxis and the desirability of ensuring a level playing field exists between these services. There is clearly a need for such a review given the challenge to the existing regulatory regime, especially coming from Uber's ride sharing service.

The key focus should be on what regulation is appropriate, not necessarily that there be a level playing field across all services. In this regard, a distinction should be made between rank and hail services and pre-booked services, including with the latter bookings through smart phone applications. The regulation of rank and hail services needs to be more stringent than for pre-booked services given that the problem of information asymmetry is greater with these services. However, there is still a need for minimum government implemented regulation of drivers and vehicles for pre-booked services to ensure minimum safety and consumer protection standards.

It is not sensible to attempt to exercise economic regulation of the taxi industry without having close regard to substitute services. If the substitutes are sufficiently close to ensure effective competition exists for point to point services, there would seem to be little need for detailed taxi fare and quantity regulation. There is a strong case for removing economic regulation of pre-booked services (not just the booking fee) provided by taxis and other providers such as hire car operators.

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<sup>7</sup> The evidence seems quite consistent with the price elasticity of demand being higher than IPART has built into its modelling.

Any review of regulatory arrangements needs to ensure that the politicisation of fare and licence number decisions is removed. This could be done by allowing the independent regulator to make determinations, rather than recommendations, and by moving to a price-based approach to leasing licences.

#### **4 Industry performance**

IPART has considered data relating to industry performance as required by its terms of reference. It suggests that the evidence indicates the industry is meeting customer expectations. The basis for this claim seems highly dubious given the evidence of perceptions relating to fares and waiting times from the Taverner Research and the evidence of falling demand from the CIE survey work. In any event, it is clear that customer expectations have been significantly diminished over time by on-going performance failures.

In summary, I recommend IPART:

- a. pursues more rigorously the objective of removing from taxi fares the economic rent component associated with unnecessary restrictions on licence numbers;
- b. reduces maximum taxi fares and recommends sufficient new licences to ensure waiting times do not increase;
- c. pushes for a price-based approach to issuing licence leases on an as of right basis; and
- d. pushes for further reforms to the regulation of taxis and hire cars that will facilitate new innovation and competition whilst ensuring the maintenance of appropriate minimum safety and consumer protections.

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