

# Review of Form of Regulation For Taxis in New South Wales

Transport - Report  
30 March 2007



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Submissions from stakeholders must be received by 27 April 2007.

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**Review of Taxi Fares in NSW 2007**  
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**The Tribunal members for this review are: Dr Michael Keating AC, Chairman,  
Mr James Cox, Full Time Member and Ms Sibylle Krieger, Part Time Member**

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## 1 INTRODUCTION

In response to a request from the Premier, the Independent Pricing and Regulatory Tribunal of NSW (the Tribunal) investigates the fares charged for taxi services regulated under the *Passenger Transport Act 1990* every year, and recommends changes to maximum fares to the Minister for Transport<sup>1</sup>. To date, the Tribunal has based its recommended changes on a Taxi Cost Index developed in 1999.

As part of its 2006 review of taxi fares, the Tribunal decided to review this approach and assess alternative approaches for recommending fare changes. The Tribunal and some taxi industry stakeholders were concerned that the existing approach relies too heavily on information provided by taxi industry participants, and requires too much time to assess changes in costs relevant to operating a taxi.

The Tribunal identified several possible approaches that could be used as a basis for adjusting taxi fares to reflect increases in costs, including using:

- an industry-specific cost index, such as the current Taxi Cost Index or a modified version of it
- the Consumer Price Index (CPI)
- the transportation or private motoring components of the CPI
- the Wage Price Index (WPI)
- a composite index consisting of a combination of Australian Bureau of Statistics (ABS) indices, such as the CPI and the WPI.

The Tribunal assessed the alternative approaches for simplicity, transparency, robustness, timeliness, cost-reflectivity, and ability to provide incentives for the taxi industry to make productivity gains. The Tribunal also assessed the approaches for their impact on taxi fare outcomes.

The Tribunal concluded that an industry-specific cost index best meets the above criteria and is the most appropriate basis for recommending changes to maximum taxi fares in NSW. However, all the inflators used to assess annual movements in the cost components of such an index should be independently gathered. The Tribunal has modified the existing Taxi Cost Index to replace the current industry-provided inflators with appropriate data from independent sources.

The sections below outline the current approach to adjusting taxi fares and explain the revised approach, and the indicative impact of this approach on price outcomes. The final section outlines the process and timetable for the 2007 fare review. The appendices summarise the process the Tribunal followed in undertaking its assessment of the options, and provide a brief discussion of the alternative options it considered.

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1 As provided for in section 60A of the *Passenger Transport Act 1990*, it is the Director General of the Ministry of Transport who determines fare schedules for taxis. His determinations may depart from the Tribunal's recommendations.

## 2 CURRENT APPROACH TO ADJUSTING TAXI FARES

Since it began reviewing taxi fares in 2001, the Tribunal has based its recommendations for fare changes on a modified<sup>2</sup> version of a Taxi Cost Index that was developed by PricewaterhouseCoopers for the Ministry of Transport and the NSW Taxi Council in 1999. The Taxi Cost Index consists of a basket of taxi operating cost components weighted according to the proportion of overall costs they represent. The cost components are individually inflated using a range of inflators, some of which are provided by the taxi industry and some of which are independently published by the ABS. Approximately half the index is inflated using industry-provided data and approximately half using ABS published indices.

Each year, the Tribunal invites the NSW Taxi Council to make a submission providing its values for the inputs to the Taxi Cost Index and proposing fare changes in line with any increase in the index. It also seeks submissions from other stakeholders. The Tribunal assesses the information provided by the Taxi Council, to determine whether the data used to quantify changes in each cost item is consistent with the description of the item in previous years, is representative of the class of costs in which the items were selected, and is verifiable as to the size of the change.

In recognition of the differences in the level and distribution of costs between urban<sup>3</sup> and country-based taxis, an Urban Taxi Cost Index and a Country Taxi Cost Index are calculated for each review.

## 3 REVISED APPROACH TO ADJUSTING TAXI FARES

Based on its assessment of each of the options listed above, the Tribunal concluded that its recommendations for changes in taxi fares should continue to recognise movements in taxi-specific costs, but that all inflators used to assess those movements should be independently gathered. In line with this decision, the Tribunal has modified the existing Taxi Cost Index by replacing the current industry-provided inflators with appropriate data from the ABS and other independent sources.

The sections below explain the Tribunal's revised approach to adjusting taxi fares in more detail.

### 3.1 Key differences between current and revised indices

Table 1 lists each of the cost components and inflators in the current Taxi Cost Index, and compares them to the revised Taxi Cost Index. The key differences between these indices relate to the following cost components:

- maintenance labour costs
- licence plate lease costs

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2 The Tribunal modified this index by including allowances for bailee driver labour and taxi licence plate values.

3 The urban fare schedule applies in Sydney, the Central Coast, Newcastle and Wollongong, as well as the Blue Mountains, Shellharbour, Cams Wharf, Fern Bay, Minmi, Toronto, Williamtown, Medowie, Campvale, Ferodale, Raymond Terrace, Fassifern, Hexham, Maitland, Beresfield, Fullerton Cove, Tomago, Camden, Picton, Thirlmere, Tahmoor and Bargo.

- LPG fuel
- insurance
- vehicle lease payments, and
- the minor cost components.

### **3.1.1 Maintenance labour costs**

The revised index uses the ABS's Wage Price Index (WPI) to track changes in maintenance labour costs. In the current index, the WPI is used to inflate other labour cost items, including notional driver's wages and operator salary equivalent. It is also generally used by the Industrial Relations Commission to set driver entitlements. However, the current index uses quotes from Ford Motor Dealers to inflate maintenance labour costs.

The Tribunal notes that over the past several years, these dealers' quotes suggest that there have been substantial increases and fluctuations in maintenance labour costs. However, there is little evidence to support the contention that movements in dealers' quotes reflect changes in efficient maintenance labour costs. Nor are all taxi operators expected to utilise official dealerships for maintenance work. Therefore, the Tribunal does not consider that the inflator used in the current index is necessarily a good proxy for actual maintenance labour costs incurred by operators. The Tribunal considers that the WPI is a more independent and robust measure of labour cost increases.

In any case, under the current weighting scheme maintenance labour accounts for around 4 per cent of total costs, so the variation in the inflator will have a relatively minor impact on the overall index. Nevertheless, the Tribunal will monitor the situation and, if the evidence suggests that the chosen inflator is not cost-reflective, it will review it again.

### **3.1.2 Licence plate lease costs**

The revised index applies the one-year bond rate published by the Reserve Bank of Australia to taxi licence plate values provided by the Ministry of Transport to inflate licence plate lease costs. In the current index, this cost item is inflated using data provided by the Taxi Council on interest rates quoted by the Arab Bank for loans secured against taxi licences.

### **3.1.3 LPG Fuel**

The revised index uses independently purchased data from Fueltrac on daily average LPG prices to track changes in fuel costs, instead of data provided by the Taxi Council based on Shell Gogas prices. Fuel costs will be assessed separately for urban taxi drivers (based on data for Sydney and Newcastle) and for country taxi drivers (based on data for NSW excluding Sydney and Newcastle).

The Tribunal considered using the fuel component of the private motoring subgroup of the CPI as the inflator for the LPG fuel cost item, but as this component principally reflects price movements of unleaded fuel it preferred the Fueltrac data.

### 3.1.4 Insurance

The revised index tracks changes in insurance costs via the insurance services component of the CPI, whereas the current index uses quotes for comprehensive third party and comprehensive car insurance from one insurer, and Workcover data for workers' compensation insurance.

The Tribunal notes that the inflator used in the current Taxi Cost Index has resulted in much higher increases in the insurance cost item over the last few years than would have occurred if the revised inflator had been used. However, it is difficult to determine whether the yearly changes in insurance costs provided by the Taxi Council reflect genuine market outcomes or the fact that the current market for taxi insurance is dominated by one player. The Tribunal prefers to use the independent measure in the revised Taxi Cost Index. However, it will monitor the situation, and if the evidence suggests that the chosen inflator is not cost-reflective, it will review it.

### 3.1.5 Vehicle lease payments

The revised Taxi Cost Index uses the motor vehicles component of the private motoring subgroup of the transportation group of the CPI to inflate vehicle lease payments. The current index uses home equity loan rates applied to a weighted average of new and second-hand car values for Ford Falcon and Ford Futura. The use of this inflator has led to substantial increases in the lease payments cost item in recent years, while average vehicle costs as measured by the motor vehicles component of the CPI have fallen.

The Taxi Council argues that the reason for the ongoing reduction in the motor vehicles component of the CPI is the broader composition of cars used by the wider community compared to taxis. In recent years, there has been an increased use of smaller and cheaper vehicles in the community, while the taxi industry has continued to need larger vehicles, which the Taxi Council claims have not benefited from industry productivity gains to the same extent.

Nevertheless, the Tribunal prefers the ABS measure for the revised Taxi Cost Index, in the interests of simplifying the methodology and utilising independent data sources. In any case, under the current weighting scheme vehicle lease payments account for around 5 per cent of total costs, so the variation in the inflator will have a relatively minor impact on the overall index. Again, the Tribunal will monitor the situation and, if the evidence suggests that the chosen inflator is not cost-reflective, it will review it.

### 3.1.6 Minor cost components

In the revised index, any cost components that comprise less than 2 per cent of total operating costs have been amalgamated into an "other" category. This category is inflated by changes in the CPI.

**Table 1 Comparison of current and revised Taxi Cost Indices**

<b>Current cost item</b>	<b>Current urban index weighting</b>	<b>Current inflator</b>	<b>Proposed inflator</b>
<b>Labour costs</b>			
Notional Driver's Wages	36.1%	WPI	WPI
Operator Salary Equivalent	7.3%	WPI	WPI
Maintenance Labour	4.1%	Ford Motor Dealers quotes for mechanical services	WPI
Driver Entitlements	2.2%	Based on NSW Industrial Relations Commission	WPI
<b>Non-labour costs</b>			
Licence Plate Lease Cost	14.2%	Interest rates quoted by Arab Bank for loans secured against taxi licence plate value from the Ministry of Transport	RBA's 1 year bond rate applied to taxi licence plate values from the Ministry of Transport
LPG Fuel	8.4%	Shell Gogas provided by the NSW Taxi Council	Fueltrac data
Insurance	6.2%	Workcover for Workers Compensation Insurance, CTP and comprehensive insurance quotes from 1 insurer	"Insurance services" component of the CPI
Vehicle Parts & Panels	5.2%	"Parts and accessories" component of the private motoring subgroup of the CPI	"Parts and accessories" component of the private motoring subgroup of the CPI
Vehicle Lease Payments	4.8%	Home equity loan rates applied to a weighted average of new and second hand car values for Ford Falcon and Ford Futura	"Motor vehicles" component of the private motoring subgroup of the CPI
Network Fees	3.4%	Set as per annual network fees	Set as per annual network fees provided by the Ministry of Transport
Tyres	1.6%	Prices provided by 1 leading retailer	Amalgamated into the 'other' category and inflated using CPI
Uniforms	1.5%	Clothing component of the CPI	Amalgamated into the 'other' category and inflated using CPI
Driver Cleaning	1.8%	Cleaning quotes from comcare.com.au	Amalgamated into the 'other' category and inflated using CPI
Govt Charges	0.5%	Set as per annual government charges	Amalgamated into the 'other' category and inflated using CPI
Operator Cleaning	0.2%	Cleaning quotes from comcare.com.au	Amalgamated into the 'other' category and inflated using CPI
Annualised Establishment Costs	0.6%	Based on industry costs for fit-out of vehicles with quotes provided by the networks	Amalgamated into the 'other' category and inflated using CPI
Other	2%	CPI	CPI

## **3.2 Revised weightings**

The Tribunal recommends that the weightings of cost components used in the current Taxi Cost Index be reviewed to ensure that they reflect the current cost structure of taxi operations. The Taxi Council supports such a review, and the Tribunal understands that the Ministry of Transport has already commissioned one. However, this review will not be completed in time to incorporate the revised weightings into the Tribunal's 2007 review of fares.

The Tribunal also recommends that the cost components in the index and their weightings be reviewed at regular intervals to ensure that the base data from which the index is compiled remains current.

## **3.3 Need for productivity adjustment**

At each annual fare review, the Tribunal will consider whether the change in fares indicated by the revised Taxi Cost Index needs to be adjusted to account for productivity gains in the taxi industry, and if so, the level of adjustment that is appropriate.

Encouraging productivity growth is a key objective of economic regulation, and the Tribunal considers that accounting for productivity gains is part of its normal price review process in regulated industries. Productivity gains are not necessarily about utilising more cost effective labour and capital inputs, but encouraging and capturing improvements in the combination of labour and capital that ultimately result in the need for fewer inputs to achieve the same level of output, or the same level of inputs to generate more outputs. For example, in the taxi industry, productivity gains could be achieved by introducing technologies or work practices to reduce non-fare-generating trips, as opposed to cutting input costs to reduce the cost of taxi services.

In the revised Taxi Cost Index, greater use is made of economy-wide measures of price changes to inflate individual cost items than in the current index. The revised Index therefore takes account of productivity changes to the extent that they influence the price of some inputs of the taxi industry. However, only a quarter of all cost items are inflated by such measures, with labour costs being the most notable exception. Moreover, it is also necessary to consider changes in the relationship of outputs to inputs within the taxi industry. As a result, the Tribunal will need to look more broadly at productivity gains as part of its review of taxi fares.

For example, even for cost items that are inflated by the CPI or its components, the Tribunal will still need to consider the extent to which productivity has changed, net of any change in input prices. In the economy as a whole, productivity growth can outpace the growth in prices, with output prices rising by less than input prices.

The Tribunal will also have to consider how to adjust for productivity without unduly disadvantaging taxi drivers, particularly because market forces are being relied on to encourage the productivity incentive to filter through to other players in an industry where market failures (such as market power and barriers to entry) exist.

## 4 INDICATIVE PRICE OUTCOMES

As part of its assessment of the alternative options, the Tribunal calculated the increase in maximum taxi fares that would have resulted from the use of the revised Taxi Cost Index for the last four years. Table 2 presents these price outcomes and compares them to those that resulted from the current index. Please note that these results are presented for illustrative purposes only, as the review of the cost component weightings recommended by the Tribunal (see 3.2 above) may alter these results.

**Table 2 Price outcomes under the Revised Taxi Cost Index and the current Index**

	Revised Taxi Cost Index – percentage increase in fares		Current Taxi Cost Index – percentage increase in fares	
	Urban	Country	Urban	Country
2002/03	2.8	3.0	4.73	5.06
2003/04	0.4	0.5	2.34	1.75
2004/05	3.3	3.4	2.87	3.48
2005/06	4.1	4.1	3.5	2.5

## 5 THE NEXT STEPS

The Tribunal is now starting its 2007 taxi fare review. The Tribunal will use the approach described above, including the revised Taxi Cost Index (with unchanged weightings), to develop its recommendations for changes in taxi fares for this review.

The Tribunal welcomes and invites submissions from *all* interested parties. These submissions should provide views on the appropriate adjustment for productivity, and any other issues that stakeholders consider relevant. The Tribunal needs to receive them by 27 April 2007.

The Tribunal will consider the information provided in submissions, and consult where necessary, before producing a final report.

An indicative timetable for the 2007 fare review is provided below:

Task	Timeframe
Receive submissions from stakeholders	27 April 2007
Tribunal's final report to the Minister for Transport	4 June 2007
Fare rise implemented	1 July 2007

## **APPENDIX 1 THE TRIBUNAL'S PROCESS FOR REVIEWING THE FORM OF REGULATION FOR TAXI FARES**

The Tribunal's process for reviewing the form of regulation for taxi fares included:

- Releasing an issues paper (as part of the Review of Taxi Fares 2006) in June 2006.
- Receiving and considering submissions from the NSW Taxi Council, the NSW Taxi Drivers Association, NCOSS and the Blue Mountains Commuter and Transport Users Association (June 2006).
- Releasing its final report on the Review of Taxi Fares 2006, which included a call for further submissions on possible future approaches to setting fares (July 2006).
- Holding a workshop to assist stakeholders in understanding how regulators seek to influence improvements in industry productivity outcomes (August 2006).
- Receiving and considering further submissions from the NSW Taxi Council and the NSW Ministry of Transport (October 2006).

## **APPENDIX 2 OTHER OPTIONS CONSIDERED FOR THE FORM OF REGULATION FOR TAXI FARE REVIEWS**

### **Consumer Price Index (CPI)**

One of the alternatives to using an industry-specific cost index is simply to adjust taxi fares each year in line with the CPI. The CPI gives an indication of the increase in prices in the economy as a whole, and takes into account economy-wide productivity gains. However, the components of the CPI do not closely mirror the cost structure of the taxi industry, and do not directly take into account changes in labour costs, which are the largest single cost driver in the taxi industry.

### **The transportation and private motoring components of the CPI**

The CPI is divided into a number of groups, and an index for each group is published by the ABS. The transportation group of the CPI is further divided into the private motoring and urban transport fare subgroups. Either the transportation group or the private motoring subgroup would more closely reflect the cost structure of the taxi industry than the full CPI, but still would not directly take into account movements in labour costs.

### **Wage Price Index (WPI)**

The ABS's WPI tracks changes in the price of labour over time. Unlike Average Weekly Earnings (AWE), which measures the level of average earnings at a particular point in time and is affected by hours worked and by compositional changes in the employee workforce, the WPI is calculated using a specific basket of jobs. As labour is such a significant input to the taxi industry, there are advantages in using the WPI as a measure of cost increases. However, it obviously does not capture movements in the price of goods, and it does not make allowances for changes in the level of productivity.

### **Composite ABS index**

The Tribunal looked closely at several different composite ABS indices, constructed using the CPI or one of its groups or subgroups and the WPI or AWE. A composite index can be structured to more closely reflect taxi industry costs than a single index.

### **Summary**

All the ABS indices are independently calculated and published and are widely available on a timely basis. Use of such an index would be transparent, simple and straightforward, and regulatory costs and information requirements would be minimal. However, on balance the Tribunal was not convinced that even the composite indices were sufficiently cost-reflective, and the revised Taxi Cost Index has been preferred.

