DISCUSSION PAPER 3

Level of fare revenue compared with costs

Taxi Roundtable – 29 February 2012

The main purpose of this year's annual review is to reweight the Taxi Cost Indices (TCIs) so that it resembles the structure of costs faced by the industry as closely as possible. This involves working out how much each cost contributes to the total cost of providing taxi services. For this process, the absolute level of each cost does not matter as much as its relative contribution to the total.

Ideally, we would like to also use the information collected by the CIE's cost survey to determine whether the level of fares require re-setting. This would involve setting fares so that on average a taxi that is run efficiently recovers its costs – no more or less. It is likely that efficient costs would be below the actual costs of some taxis and efficient revenues would be above the actual revenue of some taxis. It would be open to us to ascertain which costs are efficient and hence recoverable through fares, and which are not.

Current fares are not based on this type of analysis because the information we need to do this has not been available. This is one of the reasons we (and other regulators) use a cost index approach. It is also one reason why we develop index weightings that try to replicate the actual cost of providing services rather than the efficient costs we focus on in other industries.

The recent cost survey undertaken by the CIE obtained the actual (financial) costs of operators of around 1,000 taxis and of around 2,500 drivers. This survey has given us a good amount of information that we could use to identify efficient costs but we are less certain that it has provided a reliable estimate of efficient revenue – that is, how many fares an efficiently driven taxi takes and what the average trip looks like. Without good information on both costs and revenue it is difficult to set fares using this type of analysis.

We have received submissions that passengers need to pay more in order to raise driver incomes. We have also received submissions that argue for a large reduction in fares so they better reflect 'economic costs'. This paper discusses the available information and some of the arguments for a step-change in fares in more detail.

Should we raise fares in order to increase drivers' earnings?

In the CIE's draft report, driver earnings are measured by collecting information on fare revenue and then deducting other costs[1] – driver earnings are what is left. The CIE survey suggests that drivers receive relatively low hourly pay. On average, it found that earnings were well below the minimum wage with few if any receiving paid leave or superannuation.[2]

On the face of it, it seems reasonable to suggest that fares should be raised in order to increase drivers' take home pay. However, there are two reasons this may not be appropriate. The first is that the fare revenue reported in the CIE survey may underestimate actual revenue. In support of this, one submission refers to the fact that driver pay comes in below the threshold level used by the Australian Taxation Office as a minimum reportable income and below what drivers would get if they selected Method I for bailment[3] (ie, a commission approach where drivers and operators share fare revenue).[4]

The second reason is that the relationship between fares and driver income is complex. History suggests that raising fares significantly will not significantly increase driver earnings. Over the past 10 years taxi fares have increased significantly in real terms and by more than the average growth in wages yet driver earnings don't appear to have risen significantly over this time.[5] The CIE suggests that this may be because:

- Higher fares in the short term would increase the number of drivers and hence, pay-ins (reducing the value of higher fares to drivers) and ultimately result in higher licence lease costs.
- An increase in fares would reduce demand for taxi services, which would at least partially offset the higher fares.[6]

We have received several submissions supporting the view that raising fares are not an effective way to increase the earnings of taxi drivers.

1 Drivers' earnings equal fare revenues less driver costs (pay-ins, fuel costs and cleaning costs).
2 CIE draft report pp 48 and 60.
3 NSW Taxi Council submission, pp 3-4.
4 Under the Taxi Industry (Contract Drivers) Contract Determination, 1984 drivers have the choice of the commission approach (Method I) or the set pay-in approach (Method II).
5 Fares have increased significantly more than the Consumer Price Index and Wage Price Index.
6 CIE draft report, p 55.

Should we reduce fares because costs are lower than we thought?

The CIE survey suggests that on average, the actual cost of providing taxi services is lower than we have assumed in the past. This is partly due to the low level of drivers earnings. We assumed a higher value for these (based on the opportunity cost of drivers time) when we last reweighted the index because the previous industry survey (undertaken by PWC in 2007) did not collect reliable information on revenue. However, there are other cost items that the CIE also found to be lower.

Current fares were not set using a detailed analysis of costs and revenue. Last time we reweighted the TCIs (2008) we used a range of available estimates to cross-check fares with revenue but made no change to fares as a result. Using this approach our revenue estimates ranged from $158,400 to $243,120. We concluded that the revenue estimates were in the right order of magnitude to cover estimated actual costs of around $200,000 per taxi.

The CIE survey found that actual costs (and hence revenues) are below those we assumed in previous reviews - around $145,000 for a standard taxi in Sydney.[7] The CIE has cross-checked the revenue figures obtained from the survey with other available estimates, as we did in 2008. The CIE found that the revenue estimates from the survey are lower than suggested by the other data it has looked at but that the differences are not large. However, they note that there is considerable uncertainty regarding revenue estimates.

One submission suggested that we should consider adjusting the level of fares so that the average fare reflects the average 'economic cost' identified in the CIE survey.[8] This would involve taking CIE's average fare (ie, based on actual driver income) and removing licence fees as well as any excess profits embedded in other cost items. This submission also suggests that we introduce differential peak and off-peak fares – with peak fares increasing and fares at other times reducing.

We agree that there are a number of taxi industry costs that result from, or are higher as a result of, regulatory intervention or current industry structure. If we were to focus only on economic or 'efficient' costs in our review, there could be scope to reduce fares.

However, it is important to remember that the costs identified by the CIE are real costs faced by the industry. If regulated fares were set at a level that reflects economic costs only, there would be adverse consequences at least in the short term.

7 Some of the differences result from the different approach taken by the CIE to some cost items – eg, the use of actual driver earnings from the survey rather than a notional value. Some of the difference is also because the CIE's figures are GST exclusive, whereas the current costs included in the TCI are GST inclusive.

8 P Abelson submission, pp 2-3.

In the longer term matching fares to economic costs could put downward pressure on any inefficient actual costs, but in the short term it could create significant disruption.

Will fares be lower if some cost items are no longer included?

The CIE has recommended index weightings that exclude or change some of the cost items included in the current TCIs. Specifically, the CIE recommends:

- Using actual driver earnings instead of a notional value for drivers' income.
- Not including separate items for driver leave entitlements and superannuation.
- Changing the treatment of licence lease costs to avoid the circularity of fares and licence values.
- Not separately itemising minor items, such as the cost of uniforms.[9]

To consider the impact of these recommendations on fares, it is important to make the distinction between relative costs and actual costs. The CIE's recommendations are about the relativity between different costs in the TCIs and the way they are used to calculate annual fare changes. We have not asked them to advise us on the absolute level of these costs that should be included in fares.

Fares are not based on a build up of costs but are indexed annually by the change in costs measured by the index. Some submissions noted concern that some cost items (for example, the cost of uniforms and cleaning) have not been separately identified and captured by the CIE. Because the CIE's analysis is about weightings in the index (which always add to 100%), the treatment of minor cost items has an extremely minor, if any, impact on the level of fares.

Other submissions have argued that some costs (eg, licence lease costs) should be removed from the index, and an adjustment made to extract these costs from fares as well. One submission suggested that average taxi fares should be at least 40% lower than they currently are.[10]

9 CIE draft report.

10 P Abelson submission, p 9.

Discussion questions for roundtable

Question 1

Do you agree that raising fares will not result in higher earnings for drivers?

Question 2

Overall, the CIE survey suggests that revenue is higher than the actual cost of providing taxi services. What would happen to returns in the industry if fares were reduced? Would lower fares create more demand for taxi services?

Question 3

Are there any other justifications for re-setting the level of fares, other than to reflect changes in the annual cost of providing taxi services measured by the Taxi Cost Indices?