TAXI FARE REVIEW ROUNDTABLE

Overview

Taxi Roundtable - 29 February 2012

Welcome to IPART's roundtable for our 2012 review of taxi fares. This paper provides a brief overview of our objectives in this review, gives some definitions and explanations of key concepts, and explains our criteria for assessing the treatment of cost items and inflators in the index.

Objectives of the review

As determined by our terms of reference, we are conducting an investigation into fares for taxi services in NSW. Our first consideration, as per our terms of reference, is the cost of providing those services. We aim to ensure that the annual change in fares we recommend reflects changes in the costs of providing taxi services that have occurred since our last review.

After extensive review in 2008, we are satisfied that using two industry-based cost indices (for urban and country fares) is the best method for generating taxi fare recommendations. For this major review, we aim to **reweight** the indices to ensure that they still reflect the actual cost structures of providing taxi services, and we would like to assess current revenue levels to ensure that they are sufficient to cover costs.

What costs are we looking at?

Two submissions we received on our issues paper expressed the view that we are not clear in our definition of which costs we are trying to assess.[1] Peter Abelson's submission suggested that we ought to look at efficient **economic** costs, defined as 'the real costs to the community of operating taxis' rather than actual (financial or accounting) costs.[2] He suggests that taxi licences have no economic value, and that excess profits are potentially embedded in network fees, vehicle fit-outs and maintenance and vehicle insurance.

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.

1 P Abelson submission, p 2; D Godden submission, p 3.
2 P Abelson submission, pp 2-3.

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.

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.

For this review we consider that we should continue to focus on the actual (financial or accounting) costs of providing taxi services, rather than the economic cost. However, we are contemplating some specific changes to our current approach:

- We would like to consider the issue of fares feeding back into licence lease prices and thence into fares, which means that the financial cost to operators of a lease does most likely include embedded excess profits. Economic efficiency is therefore a criterion for assessing options in Discussion Paper 1, where we look at the treatment of licence lease costs.
- We will consider our treatment of driver and operator labour costs in the TCIs. In the past we have taken an 'opportunity cost' approach to weighting this item in the indices,[3] but for this review we will consider whether there is a way to assess the actual labour costs. Discussion Paper 2 presents this issue.

Relative costs matter for the indices

For the operation of the indices, absolute costs do not matter. Relative costs set the weightings and influence the final outcome in terms of the percentage increase that will be applied to taxi fares.

Some submissions[4] suggest that we ought to include a bigger weighting for driver labour to reflect a 'socially acceptable rate of earnings', or that the TCIs need to separately itemise all driver costs, presumably in the hope that this will lead to a bigger fare increase.

However, inflating driver labour costs in the TCIs to a higher amount and therefore higher weighting would not necessarily mean that fares increase by a higher amount.

To illustrate, consider a hypothetical simplified taxi cost index (HSTCI) made up of labour costs inflated by the wage price index (WPI), vehicle-related costs inflated by the consumer price index (CPI) and LPG fuel inflated by FUELtrac data.

In our hypothetical world, we undertake a survey of drivers and the survey data shows us that drivers earn \$40, vehicle-related costs are \$20 and fuel costs \$20. WPI this year is 4%, CPI 3% and the FUELtrac inflator 15%. Putting those figures into the index gives a HSTCI increase of 6.5% (see Table 2).

3 See for example, IPART, *2012 Taxi Fare Review Issues Paper - December 2011*, p 26.
4 For example, ATDA submission, pp 17-19.

Table 1 Hypothetical Simplified Taxi Cost Index Calculation 1

Cost item	Absolute cost	Weighting	Inflator	Contribution to TCI
Labour	$40	0.5	4%	2%
Vehicle	$20	0.25	3%	.75%
Fuel	$20	0.25	15%	3.75%
Total HSTCI				**6.5%**

If we change drivers' labour costs to $120 and put that into the index, the resultant HSTCI increase is 5.25%, a lower increase than when the HSTCI included labour costs of $40 (see Table 3).

Table 2 Hypothetical Taxi Cost Index Calculation 2

Cost item	Absolute cost	Weighting	Inflator	Contribution to TCI
Labour	$120	0.75	4%	3%
Vehicle	$20	0.125	3%	.375%
Fuel	$20	0.125	15%	1.875%
Total HSTCI				**5.25%**

This illustration shows that it is important to get the indices right, so that the increase in the index mirrors actual cost increases.

Discussion Paper 2 looks at options for calculating the weighting of labour costs within the TCIs.

How do we choose between different options for weightings and inflators for Taxi Cost Indices?

We will assess the options for treatment of lease costs and labour costs against the following criteria:

- Transparency – inflators should be verifiable and easy to understand.
- Accuracy – the estimate of changes in costs is close to the actual change in costs.
- Economic efficiency – change in taxi fares should cover the change in efficient costs of providing the service. This includes dealing with the circularity problem in lease costs.
- Stability of prices – large price fluctuations may have negative impacts on both providers of taxi services (drivers and operators) and passengers.

Ultimately our recommendations for fare changes are determined by the consideration of our terms of reference.

Absolute costs matter when considering whether current fare levels provide enough revenue to cover costs

Reweighting the indices does not in itself affect the current level of fares, just what happens to those fares in future. However, if fares contain embedded excess profits or are not adequate to cover costs in the industry because the TCIs have diverged from actual changes in costs or the industry cost structure has changed, then applying a correctly calculated TCI to a fare that is wrong in the first place will not fix the problem.

For that reason it is good regulatory practice to cross-check the adequacy of current fare levels when an index is being reviewed.

Discussion Paper 3 looks at this issue in more detail.