FINDING A CAB: A Better Deal for Taxi Customers

Cheaper and more readily available taxis are possible without expensive compensation for taxi licence owners argues **Christian Seibert**

Through all the market reforms of the 1990s, examples of taxi market deregulation in Australia were as hard to find as a cab on New Year's Eve. Only Darwin, in 1998, achieved any major taxi market reform. Taxi markets in other Australian cities remain highly regulated, with government regulating market entry by restricting the number of taxi licences, and controlling fares by mandating prices for all taxis.

Regulation continues despite various studies, many undertaken pursuant to National Competition Policy (NCP) obligations, recommending otherwise. For example, a 1993 report by the Industry Commission (now known as the Productivity Commission) found that:

> Barriers to entry and other forms of regulation have little, if anything, to do with ensuring public safety. Economic regulation results in artificially high values placed on taxi licences, which in turn leads to higher fares for all taxi users, including those on lower incomes and people with disabilities.[1]

A 1999 Productivity Commission report came to a similar conclusion.[2] The NSW NCP review of taxi market regulation stated that 'there is little point in continuing the restrictions on licence numbers in the long term.'[3]

The Victorian NCP review concluded that:

> 'Public interest' restrictions on the number of taxi-cab and other SCPV licences, when combined with the existing level of fares, have caused considerable costs for consumer; $72 million per year in greater Melbourne for taxi-cabs alone by our estimate. There was little evidence presented that there was a comparable public benefit from entry restrictions…There are likely to be dynamic as well as static efficiency costs arising from these restrictions.[4]

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The purpose of this article is not to revisit the general case for taxi deregulation, which is available through government reports, academic studies, and Jason Soon's 1999 *Policy* article.[5] Rather, it is to consider three issues that arise when deregulating a taxi market. These are whether to compensate taxi licence holders, how to tackle transaction cost problems, and how to address fluctuating demand for taxi services.[1]

Should compensation be provided?

Why compensation is an issue

Like many reform processes, taxi market deregulation has two distinct welfare effects. Firstly, there is a gain to consumers and a loss to taxi licences owners as a consequence of more competition and lower fares. In the case of Melbourne, this transfer was estimated at $66 million per year.[6] Secondly, there is a net welfare gain as more taxi trips are taken because of greater competition and lower fares. For Melbourne, this net welfare gain was estimated at $6 million per year, giving total annual gains of $72 million.[7]

Though consumers gain from deregulation, taxi licence owners oppose it and would demand compensation for the lost value of their taxi licences. If all market entry regulation is dismantled taxi licences are no longer necessary to operate a taxi and they effectively lose all their value. In 2005, the average Melbourne taxi licence was worth $347,000.[8] With 3,049 taxis in Melbourne, this represents a cumulative loss of value of over $1 billion. Therefore, compensation is one of the most important issues in taxi market reform. It can be viewed as both a legal and an equity issue.

A legal right to compensation?

Legal arguments focus on whether a taxi licence is a property right, and whether deregulation is unjust interference by the government with this property right. Legal advice to State governments suggests that taxi deregulation would not give rise to a legal right to compensation.[9] While this issue is untested in Australian courts, it did come before an Irish court when taxi licence owners challenged the government for compensation for taxi deregulation. In the Irish High Court decision in *Gorman, Kearns, and National Taxi Driver Union v The Minister of State and the Attorney General (2001)*, the court ruled that while taxi licences are a property right, there is no right to compensation to taxi licence owners where a change in government policy affects the taxi licence's value. This is because taxi licences are granted subject to an implied condition that government policy in relation to taxi licences may change in the future.[10]

An equity claim for compensation?

Though there is probably no legal requirement for compensation, equity arguments need to be considered. These arise because by deregulating taxis the government is reducing the value of assets it sold or its policies encouraged people to purchase. There are two main considerations that count against strong equity claims for compensation.[11]

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The first consideration relates to how and when taxi licences were acquired. Most taxi licences were acquired inexpensively decades ago. These owners have already enjoyed high returns on their investment and therefore should not be entitled to compensation. This argument applies also to owners of taxi licences bought from other taxi licence holders at later times. For example, taxi licences changed hands for $25,000 in 1982. These owners would also have had time to achieve good returns on their investment.

For recent purchasers of taxi licences the issues are more complex. Arguably, they were taking a risk in making this purchase. Investments in intangible assets are generally high risk and this is especially the case with taxi licences that are directly dependent on government policy. Investors in taxi licences hope to secure high returns—a taxi licence bought for $25,000 in 1982 is now worth $347,000, and high returns are normally associated with high risk. Though government policy on taxi licences has changed little over a long period of time, as the reports discussed above suggest it has been a contentious issue for over ten years. People purchasing taxi licences knew or ought to have known that the licence carried with it no guarantee that policy would remain the same. Like other high risk investors, they should not be entitled to compensation when their judgment about the future proves to be incorrect.

The second consideration concerns expense incurred as a result of the licence. Regulation can prompt investment decisions that lose their value when it is repealed. For example, tariff barriers provided an incentive for substantial investment in factories and other assets that may have no alternative uses without tariffs. Therefore there is a case for compensating investors for removing tariff barriers. However, this is not the case with taxis. The main investments are the taxi vehicle itself and taxi network membership, which are relatively small investments compared with the price of a taxi licence.

Therefore, from a legal and equity viewpoint, there is no justification for compensating taxi licence owners for taxi market deregulation. However, compensation may be advisable from a political viewpoint. It may make the reform process easier if opponents to it can, in effect, be bought off.[12]

Alternatives to compensation

As an alternative to compensation, the dismantling of entry restrictions could be phased in. In this situation, additional taxi licences would be allocated by the government every year, through an auction or some other process, until entry regulations cease.[13] While this may seem attractive, it restricts competition and therefore in the short term limits benefits of competition such as lower prices. An alternative approach would be to remove restrictions on taxi numbers completely, but initially to allow only current taxi licence owners to operate additional taxis. Under this system, new taxi operators would not provide competition for existing taxi licence owners but competition between existing taxi licence owners would increase. It would provide lower fares for consumers while ensuring that any profits from taxi operations continue to flow to existing taxi licence owners as a substitute for compensation. In the long term, all entry regulations would be abolished.

Addressing transaction cost problems

Why transaction costs are an issue

Most regulated taxi markets have fare levels imposed upon service providers by a government authority. Therefore a customer can hire any taxi and know that it will charge the same fare as any other taxi. There is no incentive to spend time comparing the fares of different taxis. However, with deregulation different taxis start charging different fares. Consequently, customers have an incentive to spend time searching for a taxi with a less expensive fare. While finding a cheaper taxi can benefit customers, it can also impose time and effort transaction costs.[14] This is one argument used in favour of fare regulations.[15]

Finding a taxi is not always simple. For example, you may stand on a street corner in Sydney hailing down taxi after taxi trying to find one with a satisfactory fare. All the while a taxi with a satisfactory fare may be driving down a nearby street where you cannot hail it. Indeed, upon publication of an opinion piece I wrote with a colleague about taxi deregulation in *The Age*, a former taxi driver contacted me to point out this problem.[16] I told him that there is a solution that combines the benefits of fare competition while addressing transaction cost problems.

Establishing an intermediary to address transaction costs

In a forthcoming article in the *Economic Affairs* journal published by the Institute for Economic Affairs in the UK,[17] I propose establishing intermediaries to address transaction cost problems in deregulated taxi markets.

Such an intermediary provides a way to match customers and taxis in the market for taxi services with minimal transaction costs. It uses a call centre with information about all taxi locations and the fare levels they are currently charging. These fare levels would be in the form of currency units per kilometre for easy comparison between taxis. This information would be transmitted and constantly updated through Global Positioning System technology linked in with the call centre network. Such technology is already under development, with Google trialing a system that monitors the location and fare level of taxis using GPS and transmits this to the internet or a closed network.

In the situation described above, a customer standing on a street corner in Sydney could still hail a taxi passing by or ring the call centre and state their location and what fare level they will accept. The call centre would locate the closest taxi with this fare level and send it to pick them up. Such an intermediary could either be a public authority or a private organisation. All taxis could be required to link in with its network and it could be funded by a small levy/fee on taxis or consumers.

Relationship with existing phone booking services
For a time, such an intermediary could function together with existing phone booking services. However it is obvious that there would be competition between these two services and that the market share of phone booking services would decrease. This is because an intermediary would provide a customer with the same service as a phone booking service, sending a taxi to pick them up at a specified location. But in addition it would also provide them with added choice in that it would have information about different taxis, from different companies, with different fares. With this added choice, customers would be likely to use an intermediary over existing phone booking services.

Fluctuating demand for taxis

Why fluctuating demand is an issue
On 7 December 2005, an article in *The Age* provided an insight into a major problem with regulated taxi markets, that of fluctuating demand for taxis.[18] The article reported that during the run up to Christmas and during popular events, demand for taxis outstrips supply. One taxi driver said that demand for taxis increased by up to 30% before Christmas. Customers can wait hours for a taxi. Demand for taxis varies throughout the year, but it also varies significantly throughout the week. On a weekday afternoon demand for taxis may be quite low, while on Friday and Saturday nights demand for taxis may be quite high. The Victorian Taxi Association, a lobby group for taxi licence owners, claims that increasing the number of taxis is not a solution to this problem. They were right, though not in the way they intended. The solution is to abolish taxi licences and regulation of market entry altogether.

How dismantling market entry regulations will address this issue
Where there is uneven demand for taxis, dismantling regulation of market entry will help adjust the supply of taxis to meet the demand for taxis. For example, without having to purchase a taxi licence a person would obtain a taxi driver's licence that is similar to a normal driver's licence but also requires them to prove that they are fit and able to drive a taxi, such as passing a test that assesses their knowledge of a city's road network. Their background can be verified through a police check. They would also buy a car, if they don't already have one, and provide evidence that it meets safety standards appropriate for a taxi service. On weekdays they could work another job and use this car for private purposes while on weekends they could run a taxi service. Alternatively, they could work another job and use the car for private purposes for most of the year while running a taxi service during Christmas and popular events.

Such an arrangement is not currently an option. Even if a person did obtain a taxi driver's licence and buy a car, as a taxi licence is expensive they would be forced to run their taxi constantly to get a return on their investment. That's why it is often the case that during the week there are lines of taxis waiting for customers and during the weekend there are lines of customers waiting for taxis. While under the proposed option we may still have to wait for taxis at times, we would be waiting a lot less. This is supported by data obtained in the case of Dublin, Ireland where market entry regulations were dismantled in 2000. In Dublin, only 20.3% of the hours surveyed in 1997 (prior to the abolition of market entry regulations) had an average waiting time of less than 5 minutes while in 2001 (after ending market entry regulations) this had increased to 60.2%. Significantly, the average waiting time after midnight was more than 30 minutes for 43% of the hours surveyed in 1997 while only 6.2% in 2001.[19]

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Using an intermediary to address fluctuating demand for taxis
One problem with taxi markets is that often taxi customers headed in similar directions end up taking separate taxis, making it more difficult for others to find one during busy periods. For

example, one customer could be standing on a street corner in Sydney's CBD wanting to go to Surry Hills while a block away another person could also be standing on a street corner wanting to go to Surry Hills. Without a way to match them with one another they take separate taxis. If there was a way, they would take one taxi together. Each would pay less and there would be an extra taxi available to transport other customers. An intermediary such as the one discussed previously could provide such a service.

In the situation described above, when a customer calls the intermediary for a taxi the call operator could ask if they would be willing to share with another customer going in a similar direction. A taxi would still immediately be sent to pick the customer up, but if another customer rang with a similar request the intermediary could inform them of the other taxi and its fare. The second customer could then decide whether or not to accept the offer. While this arrangement would not always be effective in times of low demand for taxis, in times of high demand it is likely that there would be many customers headed in similar directions, for example between the CBD and the airport on Friday evenings or between popular nightspots on a Saturday night.

The way forward

Like any form of microeconomic reform, taxi market reform is not a simple matter. What is obvious is that taxi market deregulation will tackle many of the problems currently troubling taxi markets and benefit consumers through lower prices and better service. With low-income people such as the elderly and disabled particularly dependent on taxis, deregulation would also be more equitable than the current system.

What is also certain is that any issues with taxi market deregulation, such as those discussed in this article can be addressed through appropriate market structures. What remains unexplained is the reluctance of governments to undertake reform. Perhaps this reluctance stems from an aversion to the political problems that may be a consequence of such reform. However, while governments focus on the political costs of reform, the financial costs of taxi market regulation continue to be borne by consumers. And unless comprehensive reform is undertaken, consumers will continue to pay the price for government inaction.

Endnotes

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