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Taxi!!

Reinvigorating competition in the taxi market

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EXECUTIVE SUMMARY

Taxis work well during off-peak periods on weekdays when it is not raining. In peak periods, particularly at airports or as crowds come out of sports venues or the Sydney Opera House, waits of an hour or more are common.

The value of taxi licence plates in most States and Territories exceeds $200,000. In NSW, it was $260,000 in 1998. Fares are on the high side. Taxi owners are the beneficiaries. Low-income customers are the main losers, paying a disproportionately high ratio of their income in fares.

Without drastic improvements, taxi services will not be able to service the Olympic Games. Long queues and disgruntled tourists will be very embarrassing for Sydney and Australia. Policy changes are needed now to improve taxi services by the year 2000.

The best policy would be to let the market determine the number of taxis in operation, subject only to government certification of driving ability, knowledge of services required and character references for drivers, and safety checks for cars. Registration and fare structure would have to be clearly displayed on the outside of a taxi. This would lead to an expansion of the types of taxis on offer, from luxury limousines to small vehicles. Fares would be determined by the demand for services and supply. Customers could then continue to use up-market taxis if they wished, or opt for a cheaper taxi service. Short term increases in the number of taxis for special events like the Olympics could be accommodated.

The principal cost of complete deregulation would be loss of the value of existing licence plates. To forestall serious opposition, taxi owners would require some compensation. However, the total value of licence plates in NSW is currently almost $1.5 billion.

Partial deregulation would not deliver the same range of benefits but it could increase the number of taxis, expand the types of services available, put a downward pressure on fares and an upward pressure on the quality of service.

This could be facilitated by certifying a parallel system of 'mini-cabs' to compete alongside the taxi market. These mini-cabs would operate through phone bookings, as is done, for example, in the United Kingdom. The number of registered mini-cabs could be increased gradually to avoid compensation costs for existing licence plates, but there could be a special allocation for the Olympic Games. ■

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THE CENTRE FOR INDEPENDENT STUDIES

Introduction

Anecdotal evidence suggests that there is room for improvement in the state of taxi services in NSW. This is backed up by a survey conducted in March 1998 by the NSW Transport Department. While the survey found mostly positive comments relating to driver appearance, car cleanliness and driver politeness, performance lagged with respect to waiting times, the driver's knowledge of locations and English proficiency.

Only 25.7 per cent of those surveyed thought there had been improvement in waiting times for phone bookings in the last 12 months. The figures for improvements in waiting time at ranks and on the street were lower, at 15.3 per cent and 13.7 per cent respectively. By contrast, 43.7 per cent of those surveyed thought there were improvements in driver appearance and 40.2 per cent of those surveyed thought there were improvements in car cleanliness.

By issuing new licences recently, the State Government acknowledged that there was an undersupply of taxi services.

Fares could also do with improvement, at least for Sydney residents. Forty-six per cent of Sydney residents surveyed thought that fares were too expensive, although 70 per cent of visitors thought that Sydney taxi fares were reasonable. A survey conducted in 1997 found that cab fares were highest in Sydney, where taxis received a fare increase of 17 per cent in 1996, while Victoria had the cheapest fares of all Australian states (*The Herald Sun*, 4 April 1997, p.6).

There were 5683 taxi operators licensed in NSW as of March 1999; 4473 of these operate in the Sydney Metropolitan area. There are 6100 licenced taxi-vehicles. By issuing new licences recently, the State Government acknowledged that there was an undersupply of taxi services. From August 1998, 100 additional 'peak availability' taxi licences, with restricted operating conditions were issued to address the shortage of taxis in peak hours. An extra 400 wheelchair-accessible licences were also released at a rate of 20 per month. The new licences were issued at $36,000, well below the then market rate of $270,000 (*The Daily Telegraph*, 6 November 1998, p. 17).

In November 1998, the NSW Transport Department called on Sydney taxi drivers to act as volunteer chauffeurs for the Olympics (*Sydney Morning Herald*, 6 November 1998, p. 7). More fundamental reforms are needed to prepare for the Olympics and service the growing population of NSW.

Taxi Regulation in NSW

Though the details of taxi regulations vary from one jurisdiction to another, they all take the same form. They involve regulation of entry, that is, the number of taxis; quality controls; and control of fares and/or fare setting procedures.

In NSW, taxi operators must pass background checks to ensure they are of good character and are fit and proper persons before they are licensed. They must meet government standards on financial viability, safety of passengers and the public, and vehicle maintenance. Operators must also ensure that taxis under their control are affiliated with an authorised Taxi Service Radio Communication Network, and are available for hire at all times as required by the Network.

Recent initiatives have included fitting Sydney taxis with Global Positioning Systems to monitor the location of taxis, driver protection screens and a trial of security cameras in taxis.

Background checks also apply to taxi drivers. They must pass a medical fitness test and checks on their driving record. Legislative provisions regulate appropriate behaviour towards passengers, presentation of the taxicab and Network Service Requirements. A new taxi driver curriculum which draws on standards from the hospitality industry and requires comprehensive knowledge of the road network has recently received state accreditation in NSW.

All States and Territories regulate taxi fares. In NSW, the Director General of the Transport Department has the discretion to determine fares and charges for the taxi and hire car industries. The taxi industry makes a submission to the Department

annually for a fare increase. The Department then analyses the proposal and reaches a decision based on industry and customer needs. Approved increases are broadly in line with changes in inflation.

Some fare increases above inflation are approved so that the industry can accommodate cost changes imposed by new regulations. For example, in 1996 a $1 flagfall (initial minimum charge) levy was introduced to fund safety improvements in the taxi industry. It was later removed.

Some quality control regulations are arguably justified to facilitate a properly functioning transit market and protect consumer interests. These include checks on the backgrounds of drivers, health checks on drivers and safety checks on taxi vehicles.

Some regulations are claimed to prevent abuse of the market power which has been conferred on taxi industry incumbents by the above regulations. This is true of the requirement for taxis to belong to an authorised Radio Communication Network, the regulation of maximum taxi fares and the prescription of rigorous safety and driver knowledge standards. With more open entry, some of these regulations would be unnecessary. Taxi companies of different sorts would enter the market and serve market niches with varied requirements, advertising their expertise accordingly.

The extension of quality controls beyond the minimum necessary...may allow incumbent taxi licence holders to raise entry barriers to new competitors.

However, some of the present regulations permit abuse of consumer interests. We should be suspicious of the extension of quality controls beyond the minimum necessary as they may allow incumbent taxi licence holders to raise entry barriers to new competitors. Such controls restrict competition and allow taxi operators to charge higher fares.

Fare regulation is a particularly complicated issue. As long as restrictions on the number of taxis remain, the setting of maximum fares is needed to prevent abuse of market power. At the same time, fare regulation is subject to the same problems as price fixing in any other industry. It frustrates the ability of prices to properly reflect information about costs, demand and supply, which may be particular to each segment of the market. For example, rural taxi operators have argued that the standard fare for the average three kilometre trip endorsed by the NSW Taxi Council fails to reflect their costs (*Business Sydney*, 14 August 1998, p.16).

Maximum fares set by governments may end up being too high in some places and too low in others.

Regulation and its Effects on the Taxi Market in Australia

Table 1 shows the number of taxis per 10,000 people in each State and Territory in 1991 and 1995.

Table 1: Number of Taxis per 10,000 People

State/Terr.	NSW	Vic	Qld	SA	WA	Tas	NT	ACT
1991	9.2	9.9	8.2	4.1	7.4	12.1	7.8	6.3
1995	8.6	8.5	7.9	7.4	7.2	12.9	6.9	6.9

Source: Australian Bureau of Statistics (1997)

The low ratio of taxis to the population in all Australian States and Territories is evident from Table 1. Figures for 1999 supplied by the Victorian Taxi Directorate and the NSW Transport Department reveal that there are 6100 licenced taxis in NSW and 3898 in Victoria, or 9.62 taxis per 10,000 people in NSW and 8.36 in Victoria. These compare poorly with New Zealand, where, for example, in Wellington, there are 24.3 taxis per 10,000 people.

This undersupply has manifested itself in many ways. South Australia has had a recurring problem of keeping up with demands during the Christmas holiday

period (see Box 1). In Victoria, the Victorian Taxi Association claimed that the number of new taxi drivers per month had decreased to 200 and that this fell short of demand (*Herald Sun*, 29 July 1997, p.2).

The general upward trend in taxi licence plate values in most jurisdictions shown by Table 2, after adjusting for inflation, suggests that taxi operators have been successful in increasing barriers to entry. Increased barriers to entry mean each entrant into the market needs to charge a higher fare in order to recoup her investment and it also means the supply of taxis is likely to fall short of demand. Thus, high licence values are prima facie evidence that fares are higher than would prevail in a freer market. A 1997 report by Access Economics found that a Sydney taxi licence plate was the third best investment to make, after thoroughbred horses and wine (*The Australian*, 17 September 1997, p.3). According to the NSW Transport Department, taxi licence values are closely aligned to residential house values.

Table 2: Real Cost of Taxi Licences in Each State ($)*

STATE	1991	1992	1993	1994	1995	1997	1998
NSW	199,161	224,418	222,648	218,508	234,925	284,197	260,000
Vic	133,918	145,079	133,589	161,696	187,940	263,897	265,000
Qld	171,690	195,318	195,931	192,287	185,852	258,822	267,000
SA	104,159	125,810	140,268	152,955	148,264	157,323	158,000
WA	165,967	156,866	155,854	158,418	182,719	233,447	210,000
Tas	66,387	64,605	74,587	71,015	75,176	101,499	100,000
ACT	234,643	260,688	317,274	311,374	250,587	243,597	280,000
NT	148,798	168,881	189,251	185,732	229,704	248,672	230,000

Sources: Australian Taxi Industry Association (1999); *Consumer Price Index Australia* 1991 to 1998, 6401.0.

* Licence values have been adjusted for inflation using the December 1998 quarterly index of 121.9. Indexes for years before 1998 have been constructed by taking averages of quarterly indexes. Figures have been rounded to the nearest unit.

A 1997 report by Access Economics found that a Sydney taxi licence plate was the third best investment to make, after thoroughbred horses and wine.

The effect of taxi regulations in inflating fares would fall disproportionately heavily, as do most other regulations, on the poorest in the community. Tables 3 and 4 make this clear.

Table 3: 1988-89 Taxi fare expenditures as percentage of average weekly household income

Lowest quintile*	Second quintile	Third quintile	Fourth quintile	Highest quintile
0.43%	0.29%	0.19%	0.13%	0.18%

*The lowest quintile refers to the lowest 20 per cent of the population in terms of income. Thus the second quintile refers to the next 20 per cent of the population above the lowest quintile, and so on.

Table 4: 1993-94 Taxi fare expenditures as percentage of average weekly household incomes

Lowest quintile*	Second quintile	Third quintile	Fourth quintile	Highest quintile
0.68%	0.29%	0.21%	0.18%	0.17%

Source: Australian Bureau of Statistics (1990, 1996). Calculations have been rounded down to two decimal places.

Taxi regulations also have less tangible but equally important effects in stifling incentives for innovation to serve particular markets. For example in 1996, the

Victorian Taxi Directorate rejected an application for a taxi licence by women who wanted to establish a women-only driver service, despite submissions by women's groups that such a service would help to alleviate safety fears of female passengers (*The Age*, 10 September 1996, p.5).

How to Deregulate: Regulation versus Certification

Concerns addressed by quality controls can be tackled by government certification. That is, rather than requiring taxis to abide by certain standards, taxis operators who demonstrate compliance with desirable standards (such as those currently enforced by regulations) would earn the right to place a distinctive mark of government certification on their vehicles. Such a policy would alleviate information deficiencies which are alleged to be the cause of market failures.

Concerns addressed by quality controls can be tackled by government certification.

A government-certified taxi system could coexist with a totally unregulated market for as many forms of passenger servicing vehicles as there are entrepreneurial possibilities. Consumers could decide whether to go for the safer option of taxis with certification or take their chances with unregulated taxis. The resulting choices would reflect consumer preferences for different combinations of price and quality.

The assumption that the resulting unregulated part of the market is likely to be a 'fly-by-night' and hence 'no go' area is open to question. In the absence of regulation, the market could, over time, evolve information devices that reduce the cost to consumers of monitoring quality and price if the adequate profit opportunities are there to be seized. These could take the form of private certification and brand identification through advertising.

By contrast, the costs of restricting taxi numbers are clear. Like any other supply restriction, controls reduce the availability of taxis and lead to higher fares

Box 1 – Taxi Deregulation in Australia: The State of Play

Tentative attempts at deregulation have been made by some States. However, the powerful taxi industry lobby, under the cloak of public interest, frequently resists any changes that might increase opportunities for competitive entry.
For example, South Australia's problem with meeting demand for taxis during the Christmas holidays each year led to temporary changes in December 1998, when Adelaide's 950 hire cars were allowed to be hailed off the street like taxis (*The Advertiser*, 9 November 1998, p.14).
South Australia also announced plans to issue an extra 75 licences over five years but even this minor change has led the Cabdrivers' Association of South Australia to argue that it would be 'harmful to standards'(*The Advertiser*, 12 April 1997, p.14). In South Australia, hire car operators claimed that changes introduced in 1998 would *stifle* their ability to compete with taxis (*The Advertiser*, 29 January 1998, p.11).
Victoria announced the creation of 100 new taxi licences for Melbourne in 1998 but this decision was reversed after criticism by the taxi industry (*Australian Financial Review*, 24 April 1998, p.18). A National Competition Policy review of Victorian regulation of taxis and other small commercial passenger vehicles has recently been initiated and is expected to produce a final report sometime in May 1999.
So far, the most comprehensive attempt at taxi deregulation in Australia has been undertaken by the Northern Territory (Victorian Department of Infrastructure 1999). Legislation passed in December 1998 removes restrictions on the number of taxi licences. Instead, annual licence fees will be charged to all eligible applicants. Existing licence owners are to be compensated in a lump sum by funds raised from the issue of annual licences which amount to about $27 million. Operators will still have to belong to a network and fares will still be regulated.

being charged than would be sustainable in a freer market. This is unless, by some unlikely coincidence, the total number of taxis on the road as dictated by current licensing policies, matches or exceeds the current market demand for taxis.

The capacity to charge above-market fares is then reflected by increments in the market value of taxi licences. The perversity of this situation is that these windfall capital gains only go to the original owner of the licence plate. New owners, if they buy a licence at the current market price, receive only a competitive rate of return from investments in taxi plates since they have to meet a high interest rate (actual or notional) to pay the inflated price for the plates. Furthermore, new owners now have a vested interest in raising barriers to entry to ensure a high rate of return from the investment. Owners also have a vested interest in keeping entry barriers high even where their plates were allocated below market rates because protection against new entrants will further increase their returns.

Competition in the Taxi Market

It has been argued that the taxi market differs significantly from other markets because, as it does not permit operators to sell to consumers at fixed locations, price comparisons are difficult (Shreiber 1975). It is argued that consumers tend to get the first vacant cab that passes. This is because it is more trouble than it is worth to hail a cab, find out the price, dismiss it if it is too high and wait to see if hailing another cab will secure a cheaper fare – assuming that the consumer has sufficient knowledge of the price range of a fare to make such comparisons.

Controls reduce the availability of taxis and lead to higher fares being charged than would be sustainable in a freer market.

On the seller's side, it is argued that any operators who cut their price may end up with lower revenues because of the low probability of a repeat purchase by people who predominantly hail for cabs.

It is also argued that the incentives for customers to search actively for a lower fare will decrease as the fare rises. Thus fare increases will tend to be self-perpetuating. This will draw more taxis into the market and cause greater road congestion. Thus a deregulated taxi market might lead to too many taxis and fares which are too high.

These arguments make many questionable assumptions.

Firstly, assuming that competition usually works as described above, the conclusion that fares are likely to be too high says nothing about whether fares are in fact higher than in cases where the number of taxis are limited.

The conclusion that maximum fares should be set should also be resisted because this tends to hinder the entrepreneurial process by discouraging experimentation with different fare structures. This has implications for quality of service as much as it does for price. In the absence of price regulations, some taxi owners might opt to service a luxury market by offering higher quality in return for price. They would be able to differentiate themselves from other taxis through advertising and eye-catching designs.

Secondly, how many taxis is 'too many' taxis? The benefits of having 'too many' taxis', such as greater availability and hence lower waiting time and greater convenience in bad weather has not been considered. If too many taxis lead to greater congestion, so do too many cars. The traffic congestion problem cannot be addressed by restricting the number of taxis. Furthermore, the use of cars in congested areas may be discouraged if more taxis were available. Thus, the total number of vehicles used may decrease if there were more taxis.

Thirdly and most importantly, these arguments ignore many of the institutional devices which may be used to convey price information and feedback more efficiently between potential customers and sellers (Williams 1980a).

While many taxis are flagged down on the street, taxis also ply for business at taxi ranks and by phone orders. Taxi industry structures are likely to differ between States and it is difficult to predict how they would turn out in a deregulated market.

Table 5 shows the breakdown of the taxi industry into these segments in NSW.

Table 5 –Greater Sydney Metropolitan Area: 1991 Average Weekday Taxi Trips

Type	Number	%
Booked taxi	39, 336	35.4
Hailed from taxi rank	31, 054	27.9
Flagged down	40, 772	36.7
Total taxi trips	**111, 162**	**100.0**

Source: Home Interview Survey, NSW Department of Transport (1991) Note: this data does not include travel of visitors in non-private houses. Tourists may have different usage patterns.

Taxi Ranks

Taxi ranks are usually located where there is high and consistent demand for taxis such as near airports and hotels. The consumer can choose whether to wait to hail down a taxi or walk to a taxi rank where he will find a taxi faster (Williams 1980a). This is likely to make price comparisons easier.

Three objections could be raised against the argument that taxi ranks enhance price competition.

The first is the prevalence of the convention of taking the first cab off the rank. This is likely to dampen the prospects for price competition. But there is nothing inevitable about such a convention. Williams (1980a) reports that the first taxi ranks in Melbourne were known to have been places of eager bidding. Such bidding routinely takes place in Asian cities.

The second objection is that such conventions are desirable in order to avoid the escalation of bidding wars into physical fights over customers. If this concern is a valid one, there may be a case for enforcing this convention in the case of open ranks designated by the government.

However, a taxi company or a group of taxi companies could agree to set up ranks exclusive to their members. The space for such ranks could be set aside and sold by governments and made transferable. The members of the exclusive ranks could come to their own agreements as to what rules would best maximise the return from their investments in these ranks.

A taxi company or a group of taxi companies could agree to set up ranks exclusive to their members.

There could then be competition between neighbouring ranks owned by different taxi companies. Participating companies could advertise their prices at these ranks. The effects of competition could then trickle down to the 'flagged down' market.

Phone Booking

Price competition can also be facilitated through the phone booking market. This is because the phone booking taxi operator has a fixed selling location and is likely to have a clientele consisting of repeat purchasers who care about price. Sometimes a taxi operator may operate in both the phone booking market and the 'flagged down' market. In this case price competition in the former is likely to spill over into the latter so that even occasional users of taxis will benefit.

The significance of competitive pressures introduced by phone booking is powerfully confirmed by complaints made by the taxi industry as a whole against the hire car industry. This has usually led to regulatory clampdowns on the hire car industry (see the comments on South Australia in Box 1).

Even if customers in the 'flagged down' market care little about price, they are still likely to benefit from the greater availability of cabs and reduced waiting times that would come from deregulation. In any case, it is difficult to ignore the price benefits that would accrue to customers of the other two segments of the taxi market which serve more than 60 per cent of customers.

Theory and Reality: Consequences of Deregulation in Other Countries

Critics of deregulation usually cite the counterintuitive results of taxi deregulation researched by Teal and Berglund (1987) as evidence that theory fails to match reality. Teal and Berglund studied the impact of taxi deregulation in six American cities. They found that the size of the taxi market increased by at least 18 per cent in all the cities but taxi fares rose in real terms.

However, the reasons suggested by Teal and Berglund for the failure of deregulation to bring greater benefits are either inapplicable to Australia or have been superceded by technological developments (Gaunt and Black 1994).

For instance, they argued that high entry costs into the phone order market may have hindered price competition. This is consistent with the markets they studied, where phone orders were responsible for 70 to 80 per cent of the taxi business.

Entry costs into the phone order market are less relevant today because of advances in mobile communications.

Entry costs into the phone order market are less relevant today because of advances in mobile communications. The benefits of deregulation should thus be stronger today than when Teal and Berglund conducted their research. For instance, mobile phones have made taxi drivers less reliant on radio networks and many owners now work in small, informal networks. Findlay and Round (1994) estimate that between 10 and 20 per cent of major metropolitan areas taxis now have either fixed or handheld phones.

Teal and Berglund also argued that drivers' wages in the cities studied were already among the lowest in the labour force, so that even with deregulation there would have been little scope for cost reduction. However this may not be the case in Australia. In 1993, the then Industry Commission study found that licensing added about 25 per cent to fares. Gaunt and Black (1996) calculated that regulation of the Brisbane taxi industry added an average of $1.47 per taxi ride. Furthermore, Teal and Berglund's own study showed that in one city real earnings of taxi drivers fell by 30 per cent. This suggests that without deregulation there would have been less pressure for wages to fall and taxi fares would have been higher than otherwise (Gaunt and Black 1994).

The Effects of Taxi Deregulation in New Zealand

Before 1989, the New Zealand taxi market was heavily regulated. The Director of Land Transport had authority to grant a licence to drive a taxi, to own and operate a taxi business, and grant approval to operate a taxi organisation. All drivers had to belong to an approved taxi organisation.

The Ministry of Transport controlled the number of taxi operator licences through geographically-based licencing authorities. Additional licences were granted less and less frequently. Fares were also controlled through a set fare schedule for each licence area and the requirement that a taximeter be fitted in each taxi, with a fixed fare calibrated in the meter. Organisations could apply for a review of the schedule on payment of a fee. Fares were set on a cost plus basis including a profit of 10 per cent.

There were also quality controls in the form of fixed standards for vehicles, driver competence and operator performance. Even multiple hiring was limited to two people at specific pick up points.

All of this changed with the passing of the *Transport Services Licensing Act 1989*, effective from 1 November 1989.

The legislation removed quantitative controls on entry and fares. Taxis and limousines were defined as Small Passenger Vehicles and the owners of such vehicles were required to have a passenger service licence. The holders of these licences could operate any number of vehicles they wanted.

Fares were to be set by individual taxi organisations with the maximum fare registered with the Transport Department, calibrated on the taximeter, and displayed both inside and outside the taxi.

All those holding a licence on 1 November 1989 were automatically issued with a passenger service licence. Issue of licences for new applicants was conditional on passing a 'fit and proper person' test and obtaining a Certificate of Knowledge after successful completion of a test of knowledge and understanding of laws and safety requirements. Licence holders were still required to belong to an approved taxi organisation, one which provides a 24 hour, seven days a week service with a radio booking and communications system.

Drivers also have to be licensed and are subject to checks on their criminal and driving record, passing a map reading test and first aid certificate test and an annual medical exam.

A recent study found that of the 28 taxi companies operating in the largest taxi market in New Zealand (Auckland) on May 1994, only nine existed before October 1989 (Morrison 1997). The number of taxi vehicles in the Wellington regional market increased from 454 in October 1989 to 932 in November 1994.

The growth in the number of taxi licences has outpaced population growth in Wellington, leading to the numbers of cabs per 10,000 increasing from 14.9 to 24.3.

A report by the New Zealand Transport Department on the state of the taxi industry at 31 July 1995 commented that since 1989, 'queues of people waiting for taxis have been replaced by queues of taxis waiting for people.'

There have also been changes in taxi deployment which suggest more flexible practices in the industry. Many firms are now employing part time drivers and subcontracting has increased.

The Wellington market also showed evidence of service innovation. Many new specialised taxi type services sprung up, including taxi vans and executive cabs. There is also a new taxi charge credit system and more advertising on cabs. Some taxi companies have also begun tendering for public bus routes.

Anecdotal evidence suggests that the taxi market has been able to sustain growth that outpaces population growth because the greater availability of taxis and improved ease of payment has expanded the use of taxis. Customers have benefited from the expanded market through reduced waiting times and the increased range of services available.

The greater availability of taxis and improved ease of payment has expanded the use of taxis. Customers have benefited from the expanded market through reduced waiting times.

Various surveys of the Wellington market have shown that the real price of taking taxis has fallen even though nominal fares have increased overall. Morrison (1997) cautions that in the period surveyed, New Zealand's inflation rate fell significantly, but he concludes that competitive pressures must have played a part in making it almost impossible for small firms to raise prices unilaterally during this period.

The New Zealand Transport Department found that taxi fares for the majority of companies decreased by as much as 10 per cent from 1989 to 1995. In the major metropolitan areas of Auckland, Wellington, Christchurch and Dunedin, 71 per cent of taxi companies reduced their flagfall and 77 per cent reduced other fares.

Morrison notes that the most significant effect on pricing arising from deregulation was the introduction of differential pricing components. This is also of economic benefit as it increases allocative efficiency, meaning that resources are allocated to their highest valued uses, so prices being charged to people using different segments of the taxi market more accurately reflect their demands and relative scarcities of the resources used in different services.

The behavioural changes following deregulation were also significant. It was found that after deregulation, most empty taxis waited at taxi stands (Morrison 1997). Taxi stands are more likely to facilitate comparison of prices and information gathering, at least for future use. There was also evidence of voluntary industry standard-setting and differentiation. The New Zealand Taxi Federation, representing about 50 per cent of the taxi industry, set higher standards for its members (New Zealand Ministry of Transport 1999).

Morrison also highlights an often-neglected benefit of taxi deregulation – it opened up new employment opportunities for those without formal qualifications.

The New Zealand experience suggests that there is little cause for alarm on safety grounds. Between 1991 and 1993, 11 drivers were disqualified for sexual and/or violent offences, but nine of these were in the industry prior to deregulation (New Zealand Ministry of Transport 1999).

Compensating for Deregulation?

The issue of compensation invariably follows the call to deregulate taxi licensing. It is clear that the scarcity value of licences held by incumbents will fall with the removal of quantity restrictions on taxi licensing.

The compensation issue is both a moral and practical one.

Morally it is argued that in the interests of equity and fairness, licence holders should be compensated for the loss of their scarcity rents because government policy has disproportionately disadvantaged them as a group. Alternatively it is argued that the licenceholders obtained their taxi licence plates in the legitimate expectation that current arrangements would continue, otherwise they would have invested elsewhere and possibly made better returns. Any form of investment, however, involves a degree of risk. Moreover, it is surely unreasonable to expect that particular economic frameworks will never change.

The moral case for compensation is fraught with difficulties. It could be argued that the high return licenceholders get for taxi licences already compensate for high risk, the major risk being that of deregulation. Consequently there is then no justification for compensation.

The practical case for compensation is a bit harder to avoid. Reform is less likely to be disruptive if affected interests can be 'bought off'. Though New Zealand succeeded in deregulating its taxi industry without any compensation, it did so in an extraordinary period when many other reforms took place.

A longer phase-in period could be traded off for lower compensation because the industry would have more time to adjust.

However, full compensation may not be a desirable option given that taxi licence values reflect the present value of future excess profits. This means that full compensation would entail the benefits of deregulation being offset by payments presumably funded by taxpayers, not all of whom would be taxi users. This means that some taxpayers would be worse off than before.

In its 1994 report on urban transport, the then Industry Commission recommended that the best means of compensation is to sell new licences by public tender and distribute the proceeds in equal shares to existing licenceholders. This proposed scheme would only partially compensate for the loss of licence values (Gaunt and Black 1994). This would continue until no more bids are received, in which case, new licences would be issued on demand at no more than their administrative costs. The amount of new licences sold in any given time could vary depending on how much compensation the State is willing to pay out. A longer phase-in period could be traded off for lower compensation because the industry would have more time to adjust.

The Northern Territory's compensation measures while deregulating its taxi industry seems to have been successful in placating the industry. It resembled the Industry Commission's recommended scheme (see Box 1). It involved distributing the proceeds of an annual licence fee to existing licence holders. However, if the compensation involved is substantial, in order to raise sufficient revenues, the new licence fees may have to be set at prices which would constitute anti-competitive barriers to entry. Based on latest figures, the total value of taxi licence plates in NSW is almost $1.5 billion.

An Alternative to Full Deregulation

If the route to full deregulation is too difficult for governments to take, the next best option is to introduce a competitor to the taxi system in the form of a 'mini-cab' system such as operates in the United Kingdom. 'Mini-cabs' and their drivers are certified to ensure safety. They may be any size. They cannot ply for trade on the

street, being restricted to the phone-order business. In NSW, the lead-up to the Sydney Olympics indicates that there is an urgent need for improved transport options such as may be provided by this proposal.

The conditions for certifying a 'mini-cab' could be significantly less strict than those for current taxis. They could be restricted to minimum necessary safety and quality control regulations such as driver checks, and checks on the condition of the motor vehicles, and fare-setting procedures such as a requirement that the fare be posted outside the mini-cab. Currently operating taxis would have the sole right to pick up fares off the street. 'Mini-cabs' would only be allowed to compete in the phone order market.

The parallel system of 'black cabs' and a 'mini-cab' system has worked well in the United Kingdom. There are no quantitative licensing restrictions on London's black cabs. Drivers are required to pass rigorous knowledge tests which form substantial entry barriers. The 'mini-cab' system has played a significant role as a competitor despite the restriction that they cannot pick up fares off the street.

'Mini-cabs' could be added gradually to avoid substantial compensation costs, but an especially large allocation of licences could be made to service upcoming demands of the Sydney Olympics.

'Mini-cabs' could be required to have clearly distinguishable marks to delineate their status as certified 'mini-cabs'. The government's main role after certification of 'mini-cab' company operators and drivers would be to remind consumers of the distinctiveness of this service.

Pursuing such a strategy of deregulation would reduce the calls for compensation of current taxi licenceholders. Taxi operators would be likely to complain that the scarcity rents of their licences would be diminished by increased competition, but the rent decline would be gradual. Moreover, 'mini-cabs' are clearly a separate transport option from taxis, like the bus system, and would be clearly differentiated as such.

The best policy would be to allow the market to determine the number of taxis in operation, subject only to government certification.

Conclusion

Without drastic improvements, taxi services will not be able to service the Olympic Games. The best policy would be to allow the market to determine the number of taxis in operation, subject only to government certification of driving ability, knowledge of services required and character references for drivers and safety checks for cars. Registration and fare structure would have to be clearly displayed on the outside of a taxi. This would lead to an expansion of the types of taxis on offer.

The principal cost of complete deregulation would be loss of the value of existing licence plates which would no doubt prompt calls for compensation by the taxi industry lobby.

Partial deregulation may be the most expedient option if improvements are to be made before the Olympics. This could be facilitated by a parallel system of 'mini-cabs' which compete alongside the taxi market. These 'mini cabs' would operate through phone bookings, as is done in the United Kingdom.

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