



# Regulation of the Taxi Industry

Commission  
Research Paper

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# Foreword

Taxis and hire-cars provide important transport services. They are also among the most highly regulated industries in Australia. All jurisdictions are required to review their regulatory regimes for taxis and hire-cars as part of the National Competition Policy legislation review process. Some reviews are underway and some are complete, but only one jurisdiction — the Northern Territory — has reached the stage of implementing a reform program for the industry.

The Industry Commission examined taxi regulation in its 1994 report on Urban Transport. This research paper builds on that work — particularly its assessment of the rationales for entry restrictions and fare regulation, and its analysis of compensation and adjustment issues. The paper is intended to complement individual reviews by providing policy makers in different jurisdictions with a common framework for assessing key issues in taxi regulation.

The analysis in the paper demonstrates that the removal of restrictions on taxi numbers would clearly bring benefits to the community. However, the paper recognises that the characteristics of taxi markets differ among jurisdictions, which means that the appropriate level and form of regulation are also likely to differ. Similarly, different circumstances could require different approaches to adjustment and compensation. Partly for this reason, the paper canvasses policy options in these important areas, rather than endorsing any particular approach.

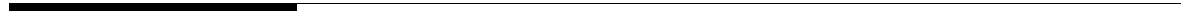
Gary Banks  
Chairman  
November 1999



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# Summary

Largely because of their 24 hour-a-day availability and capacity to provide door-to-door service, taxis are an important complement to regular scheduled services provided by other forms of public transport. Taxi services are particularly valuable to less mobile groups in the community, such as elderly and disabled people.

It is important that such services are efficiently provided, meet users' needs and are appropriately priced. There have been long-standing concerns that these objectives would not be fulfilled in the absence of government intervention. Consequently, governments in Australia, and in many other countries, have traditionally tightly regulated the provision of taxi (and hire-car) services.

Entry restrictions have been a key component of the regulatory regimes. Because of this, and commitments made under the Competition Principles Agreement to review regulations that limit competition, all states and territories are required to review their taxi and hire-car regulations. This paper, which draws on an earlier Industry Commission report on Urban Transport (IC 1994), is intended to assist review bodies by providing a framework to assess some of the key issues. The major focus of the paper is on the regulation of taxis rather than hire-cars.

For the most part, the paper explores different policy approaches rather than advocating a particular position. This reflects significant differences between taxi markets and associated administrative arrangements in different parts of Australia (see box) which, in turn, imply that the most appropriate policy response could vary between markets.

## **Assessing regulation**

Regulation of taxis generally encompasses quality and safety, as well as taxi numbers and fares.

### *Quality and safety regulation*

Users do not have the capacity to assess all quality and safety aspects of the taxis they engage. A key example is the roadworthiness of the vehicle. Largely for this

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reason, some regulation to specify minimum levels of safety and service quality is warranted. Nonetheless, some existing regulation does not have a strong rationale. Examples include regulations in some jurisdictions that prescribe maximum vehicle age and the minimum size of taxis.

### **Differences in Australian taxi markets**

Across Australia, the nature of taxi markets and the form and extent of regulation and the associated administrative arrangements vary significantly. The following points draw on a range of different markets to illustrate some of these differences.

- *Market segmentation:* In small country markets (and the ACT) the ratio of taxis hired from ranks or hailed from the street is small relative to phone bookings. In large markets, such as Melbourne, this 'cruising' trade is far more significant.
- *Industry structure:* In Sydney, there are 12 taxi companies and 3 radio networks, whereas Canberra has only one combined taxi and booking service.
- *Participation:* Half of Sydney's taxi licences are held by owner-drivers and half are held by investors. In Western Australia, investors hold about 60 per cent of the licences. Prior to deregulation, investors held 80 per cent of the licences in the Northern Territory.
- *Entry restrictions:* In the Northern Territory, the number of taxi licences is no longer restricted. Restrictions apply in other jurisdictions.
- *Number of taxis relative to population:* Taxi 'densities' are reflected in licence values which range from around \$100 000 in Tasmania (about 13 taxis per 10 000 people) to \$270 000 in Queensland (about 8 taxis per 10 000 people). In parts of the New South Wales north coast, licences are valued at around \$350 000.
- *Licence allocation:* Licences traditionally have been freely allocated (often based on seniority). However, more recently, some jurisdictions such as New South Wales and the ACT have, on occasions, auctioned new licences. Trading in licences is common throughout Australia.
- *Fares:* Victoria has a fixed single tariff fare structure. Other jurisdictions have regulated maxima and multiple rates. Average fares vary among jurisdictions (between \$6.25 in Darwin and \$7.85 in New South Wales for a 5 kilometre journey).
- *Taxi dispatch services:* In most jurisdictions, taxis must belong to a dispatch service, but this is not the case in Western Australia.
- *Drivers/vehicles:* In the ACT, the type of vehicle is not specified, whereas minimum vehicle size dimensions apply elsewhere.
- *Hire-cars:* In South Australia, the number of hire-cars is unrestricted (licence value of \$1000) and, hence, direct competition with taxis is strong. In most other jurisdictions, entry restrictions apply. In Victoria, the entry restrictions give rise to licence values in the order of \$80 000.



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### *Regulation restricting entry*

The grounds for restricting entry are generally not well articulated. The restriction is usually justified on the grounds that it is needed to enhance safety (by increasing returns and, hence, taxi operators' financial capacity to comply with safety requirements) and to constrain fare increases.

The Commission does not consider that there is a compelling case for entry restrictions on either of these grounds.

- Where the restrictions lead to higher returns, the beneficiaries will be taxi licence plate holders. However, many licence holders lease their plates to others and, therefore, are not directly responsible for vehicle safety. Even where plate holders operate taxis themselves, there is no guarantee that higher returns would improve safety. Safety concerns are best addressed directly — by regulations, supported by appropriate enforcement and sanctions.
- In the absence of entry restrictions, there would be a larger number of taxis. In this more competitive environment, fares are more likely to fall than to rise.

Indeed, a major disadvantage of entry restrictions is the effect they have on increasing fares and/or extending waiting times for taxis. These costs, which are ultimately borne by consumers, can be significant. For example, based on the current annual cost to lease a taxi licence in Sydney (about \$18 700), the cost to users of Sydney taxis resulting from entry restrictions is estimated to be in the order of \$75 million per year. Studies show that this cost is borne most heavily by low-income households.

The regulatory restrictions on competition also reduce the incentive for taxi operators to be innovative and explore new ways of cutting costs and providing services to better meet users' needs. For example, in some countries, part-time operators help overcome peak demand problems, and in some areas mini-cabs are used to provide a lower cost service.

The Commission has been unable to identify benefits to the community that justify restrictions on taxi numbers. Accordingly, it considers that there is a strong case for the removal of such restrictions. However, as entry restrictions underpin the value of taxi licences, a concomitant assessment of the implications for compensation and adjustment assistance is warranted (see below).

### *Fare regulation*

In most of Australia, fare regulation takes the form of a prescribed maximum fare. The regulation is intended to prevent undue fare increases that could otherwise arise

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in an environment where competition is constrained by entry restrictions. In practice, the maximum prescribed fare usually becomes the norm for all taxis.

Two alternative pricing options that have been commonly considered in reviews of taxi regulation are complete fare deregulation (which was adopted by some US cities in the 1970s and, more recently, in Sweden) and posted prices (which apply in New Zealand).

- Complete deregulation would permit individual taxi operators to determine fares. It would allow, for example, drivers to negotiate fares directly with individual passengers or to determine the distance-related rate to apply where fares are based on meter readings.
- A posted fare arrangement would require taxis to display publicly the fares they elect to charge. When they wished to change fares, they would first have to notify the administering authority before the new fares could come into effect.

A weakness of fare deregulation is the capacity it would provide drivers to exploit users by making on-the-spot decisions to charge excessive fares at times when taxis are in short supply — such as when it is raining during peak periods. Uncertainty about fares and a reluctance to ‘haggle’ with drivers could also make this approach unpopular with some users. A posted fare regime would overcome these shortcomings, but would still provide the flexibility for taxis to compete against each other by offering different combinations of price and quality of service.

Both options could prove unsatisfactory at major airports, however, where passenger numbers are high and large volumes of baggage have to be loaded. At these ranks, the objective of loading and dispatching vehicles expeditiously could be frustrated if, rather than taking the taxi at the head of the queue, passengers ‘shop’ up and down the rank to find the taxi which offers the cheapest fare. For these reasons, a fixed regulated fare could be warranted at the main airport rank. However, to give airport users the opportunity to take advantage of lower fares, it would be desirable (where feasible) to provide a separate area to be used by taxis that offer discount fares. Such an arrangement already exists in a number of countries.

The need for a regulated fare at some airports raises the issue of whether, for the sake of simplicity, another option should be considered for some cities — retaining the industry-wide prescribed maximum fare. In the absence of entry restrictions, a regulated maximum fare would be likely to produce a variety of outcomes rather than the uniform fare presently observed. And, with hire-cars available to service the premium end of the market, the usual concern that fare regulation would discourage the provision of higher quality services would not arise.

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The best approach will depend on the characteristics of the particular taxi market. For example, in large cities where a significant proportion of business derives from ranks, a posted fare system may be best. In some small centres where phone bookings dominate, full deregulation could be appropriate.

However, as a transitional measure, there is a strong case to retain maximum fare regulation if entry restrictions are *progressively* removed. This would guard against unwarranted price increases during the period when licences are still relatively scarce. It may mean that, initially, most taxis would charge the regulated fare. However, as the number of licences increased, the likelihood of discounts from the regulated fare would also increase.

## **Compensation and adjustment assistance**

The removal of entry restrictions would result in holders of taxi licences — many of whom are owner-drivers with no other source of income — incurring substantial losses (up to \$250 000 or so). This change, coupled with a move away from regulated fares, would also represent a significant departure from the arrangements to which the industry and its customers have become accustomed over many decades. For these reasons, there is a need to consider adjustment assistance and compensation.

Adjustment assistance — that is, measures to help individuals and, in some instances, organisations, adjust to change — has accompanied some past reforms. One way of facilitating adjustment — phasing of reforms — is particularly relevant to the taxi industry. The progressive relaxation of entry restrictions could facilitate an orderly transition to a less regulated environment. As noted below, it could also reduce the need for compensation. However, in assessing the scope for phasing, it is important to recognise that it is not a costless option — by definition, it defers the delivery of consumer benefits arising from deregulation.

Compensation is an even more complex issue. The main rationales for its provision centre around: property rights; overcoming resistance to reform; and ‘fairness’.

Some would argue that taxi licenses are akin to a property right, the value of which has been underpinned by regulation. License conditions do not specify that governments are obligated to protect license values. However, it is relevant to consider whether past government actions could have signalled such an intention. The long-standing nature of restrictive licensing, the agreement of governments to the sale and lease of licenses, and the action of some governments in selling licenses at market value, could have led license holders to believe that they hold an asset, the value of which would continue to be underpinned by government. By the same

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token, such claims would be weakened if, in the past, a government had announced an intention to significantly increase the number of taxi licenses in the future or, alternatively, had made ad hoc increases in license numbers (and, hence, decreased license values). Past statements by governments on their general approach to legislation that restricts competition could also be relevant.

Claims for compensation on the grounds of ‘fairness’ are also difficult to assess.

The size of the losses is clearly one factor. Few would dispute that losses to individuals in the order of \$250 000 would be substantial.

It is also relevant to consider how governments have responded in other situations where a policy change has seriously disadvantaged individuals. However, in practice, it is difficult to distinguish the circumstances that have led governments to choose between different approaches. The decision to provide financial assistance in exchange for dairy industry deregulation is a recent example of compensation. But, often, significant losers from government policy changes are not compensated — for example, decisions that adversely affect local businesses (eg to construct a highway bypass) and the removal of import quotas on some manufactured goods have typically not been accompanied by compensation.

Governments will also face more pragmatic issues when considering whether compensation should be provided. For example, it may be relevant to consider whether compensation would avert the possibility of reforms being stalled, or perhaps even overturned, as a result of lobbying by potential losers. A contrary consideration is the effect that a decision to provide compensation could have on the incentives for those disadvantaged by other government reforms to mount more intensive lobbying campaigns.

Overall, there is no hard and fast rule for determining whether, and to what extent, compensation should be provided. Instead, a range of factors will need to be considered in the context of the particular circumstances of each jurisdiction (see box 4.3). In considering these factors, governments will have to make some difficult judgements.

If governments opted to provide compensation, the level and distribution of payments would require close attention. Some key factors that should be recognised in addressing these issues include:

- there is generally an inverse relationship between the length of phasing and the amount of compensation. Indeed, lengthy phasing could obviate the need for compensation;
- as compensation should be limited to the losses incurred by licence holders, any value associated with goodwill or acquiring a job embedded in the current value

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of taxi licences should be disregarded for compensation purposes — these values would not be significantly affected by the removal of entry restrictions;

- funding compensation by increasing existing state or territory taxes would result in significant costs (the so-called ‘deadweight cost’ of taxation); and
- compensation payments could be allocated equally between licence holders but, if payments are limited, there could be merit in considering whether they should be skewed in favour of more recent purchasers of taxi licences or, alternatively, licence holders that would be most disadvantaged by the removal of entry restrictions.

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# 1 Introduction

Taxi and other hire-car services are a vital component of the urban transport system in Australia's major cities. Their flexibility — in terms of their operating hours and, more particularly, their pick-up points and destinations — complements regular scheduled services provided by other forms of public transport (ie urban rail, bus, tram and ferry services). Taxi services are particularly important for some groups for whom alternative public transport is not suitable — such as some elderly and disabled people, and unescorted young children.

It is clearly important that taxi services operate efficiently and that the services provided closely mirror users' needs. To this end, governments throughout Australia have sought to develop taxi services that are characterised by 'acceptable' waiting times, high levels of safety and quality (including reliability of service), and affordable prices. However, to achieve these objectives, governments have introduced regulatory regimes that tightly constrain the way in which services are provided. In most jurisdictions, this encompasses a web of regulations governing the quantity, quality and price of taxi services.

Under the Competition Principles Agreement (CPA) agreed to in April 1995 by the Commonwealth and all State and Territory governments, all jurisdictions are required to review legislation which restricts competition by the year 2000. The underlying principle accepted by all governments is that legislation should *not* restrict competition unless it can be demonstrated that:

- the benefits of the restriction to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

There have been longstanding concerns about the anti-competitive effects of taxi (and to a lesser extent hire-car) regulation, particularly restrictions on entry to the industry. Thus, to meet their commitments under the CPA, governments throughout Australia are required to review their taxi and hire-car regulatory regimes.

This paper has been prepared as an aid to state and territory review bodies. It draws on previous experience and analysis by the Commission and its predecessor, the Industry Commission, which, in reports released during the 1990s, have examined most elements of Australia's public transport system and associated infrastructure,

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the most recent being the 1999 report into Progress in Rail Reform (PC 1999). The broad regulatory framework that applies to taxis and hire-cars in most Australian jurisdictions was examined in the 1994 report into Urban Transport (IC 1994).

This paper comments on only some of the components of taxi and hire-car regulation that apply in various jurisdictions in Australia. In doing so, it focuses on those areas in which reform has the potential to yield the greatest benefits. To this end, the major focus of the paper is on taxis rather than hire-cars.

The next chapter briefly outlines some of the main characteristics of the various sub-markets for taxi and hire-car services. Chapter 3 discusses the need for government regulation in these markets and the effects of existing regulation. The final chapter discusses implementation issues, in particular compensation and adjustment assistance.

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## 2 The nature of taxi markets

Taxi services are one of the few industries in Australia where the price, the quantity and the quality of the service are all regulated. This level of regulation of a service which is characterised by many small suppliers — for example, there are over four thousand taxis in Sydney — implies that there are factors at play which, in the absence of regulation, would result in ‘poor’ outcomes for the community at large. The form of the regulation suggests that these shortcomings could involve factors that:

- prevent consumers making effective choices;
- hinder the efficient operation of service suppliers; or
- otherwise lead to adverse social impacts on the community.

To understand the rationale for regulation, it is necessary to consider the nature of the transactions in the industry and the problems that could arise if it was not regulated. These matters are discussed below.

### 2.1 Market segments

There are a number of players in the taxi industry, each with different interests. As background to the discussion of taxi markets, box 2.1 provides a snapshot of the structure of the industry in Sydney and Canberra.

Although all taxis offer broadly similar services — providing door-to-door passenger services on demand — their activities can be segmented into a number of sub-markets:

- taxis that are hired from a rank;
- taxis that are hailed from the street; and
- taxis that are booked by phone.

Hire-cars compete with taxis for phone bookings. However, mainly because of regulatory constraints, they do not compete closely with taxis in other market segments (although some hire-car operators seek to attract passengers at airports, major hotels and the like).



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### Box 2.1      **Structure of the taxi industry**

The structure of the taxi industry varies across jurisdictions. This is illustrated by a comparison of the situation in a very large market, such as Sydney, with other markets. The Sydney taxi industry has five main (although often overlapping) participants:

- *licence owners*: Owner-drivers and those who lease their plates to taxi companies or individual operators. In total, there are 4395 taxi licences.
- *12 taxi companies (and co-operatives)*: Companies or cooperatives who sell bundled services (eg insurance and repairs) to operators, but who may also manage licence plates and operate taxi businesses.
- *3 taxi networks*: Taxi companies that also provide phone booking, dispatch and safety services (eg silent alarms) to their own members and to other taxi companies.
- *Operators of taxis*: Operators can be owner-drivers, someone leasing a plate and operating a vehicle, or companies (or individuals) that manage multiple licences, vehicles and drivers.
- *20 097 (including non-active) drivers*: Drive their own vehicles (as operators) or contract their services to operators.

In contrast, in the ACT, one taxi company effectively has an operating monopoly for taxi booking services (apart from some competition from users that book directly with drivers equipped with mobile phones). While a person in the ACT may only hold two licences, there are fleet operators — the largest operator leases 22 licences. Similarly, the Northern Territory had, prior to deregulation, one taxi network. Since deregulation, this has grown to three networks.

In smaller regional markets, the industry might comprise a couple of taxis and a small dispatch service.

*Sources*: IPART 1999, FRG 1999.

The rank and hail markets are often called the ‘cruising market’, and are similar in some aspects (eg neither involve taxis travelling to a specified pick-up point or passengers organising services through a base). In contrast, there are marked differences between the cruising and phone markets that have implications for the regulation of each.

The proportion of taxi revenue generated from each market varies significantly between cities, in part depending on population size and density of the area served, as well as the availability of alternative transport options. For instance, in Sydney, rank fares comprise about 35 per cent of the market, hail fares 25 per cent and

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phone bookings 40 per cent.<sup>1</sup> In contrast, in the smaller and more dispersed Canberra market, hail business is insignificant and phone bookings substantially outweigh business from ranks.

In each market segment, demand for taxis is highly variable depending on the time of day, the day of the week and the time of the year (eg the volume of work tends to increase over holiday periods). Climatic factors, particularly rain, also affect demand.

Taxi (and hire-car) services need to be flexible to meet this variability. Like many industries, the level of capital required (mainly vehicles) to meet peak period demand is substantially greater than that required at other periods. In its Interim Report on taxi and hire-car regulation, IPART (1999) presents data showing that, under current arrangements, the supply of Sydney taxis (the proportion of taxis working at one time) adjusts to give a relatively constant level of occupancy (that is, the number of taxis occupied as a percentage of the number working is similar at any point in time). This implies that taxis will be available only if they can earn sufficient revenue to make it worthwhile. Hence, in off-peak periods, a significant proportion of the taxi fleet is off the road.

There is a high degree of substitutability between each market segment. For instance, in many situations, consumers will have a choice of options: walking to the nearest rank if they cannot hail a taxi, or phoning for a taxi. However, as indicated below, there are also clear differences between markets.

## **2.2 The rank and hail taxi markets**

Throughout Australia, specific kerb-side areas are designated as taxi ranks. They are generally located in areas of relatively high demand for taxis (eg adjacent to shopping and entertainment centres and large office complexes). Ranks are also a convenient holding bay in off-peak periods. Under the current arrangements of largely undifferentiated supply, consumers select the first taxi from a queue or wait in line at the rank until a taxi arrives.

The airport is the most significant taxi rank in most major Australian cities. In Sydney, taxi travel to and from the airport accounts for 25 per cent of total taxi trips (and possibly a greater proportion of total distance travelled by taxis) (IPART 1999).

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<sup>1</sup> The proportion in each market is also influenced by the regulatory regime (for instance, with no entry restrictions and more taxis, the hail and rank markets could be relatively bigger).

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It is often argued that the nature of the transaction required to engage a taxi at a rank or to hail a taxi in the street makes it difficult for consumers to make informed choices. For instance, in terms of quality, it is virtually impossible for consumers arriving at a rank or hailing a taxi to quickly and fully assess the quality of the service they are buying. It is not possible for consumers to know the geographical knowledge or the driver's ability to communicate effectively. Nor — given that taxis are often engaged when time is an important consideration — is it realistic to presume that consumers have the time (or the technical know-how) to inspect and make judgements about the cleanliness or roadworthiness of a cab before engaging it.

In terms of fares, it is often argued that, in the absence of regulation, undesirable outcomes could result. During off-peak periods, this could involve overly aggressive price competition with drivers arguing over fares amongst themselves, and with passengers. There is some evidence that this occurred in the United States when fares were fully deregulated, and it is a feature of some other overseas taxi markets. In contrast, in periods of high demand when taxis are scarce (for instance, when it is raining during peak periods), consumers are in a weak bargaining position and could be subject to excessive pricing — often termed 'price gouging'. The ability to price gouge arises from a taxi having temporary market power because potentially high search costs in locating another taxi substantially reduce consumers' capacity to negotiate.<sup>2</sup>

At some ranks where demand is very high — primarily at airports — it is important to the efficient movement of large numbers of people that the time taken for each consumer to engage a taxi is minimised. A situation where consumers are negotiating with a range of cabs — and delaying pick-up times — could be considerably less efficient than the present convention of passengers taking the first cab off the rank.

## 2.3 Phone bookings

With phone bookings, a consumer pre-selects a taxi (or hire-car) company from those that operate in a given area. (However, in smaller cities the choice is often limited — for example, there is only a single taxi cooperative in Canberra.) To supply services in the phone market, a taxi generally needs to be part of a network

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<sup>2</sup> Price gouging should be distinguished from higher prices that serve in some industries (eg electricity supply) to ration available supply during peak times. Price gouging implies a level of prices that exploit consumers' weak bargaining position.

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since, owing to unevenness in the flow of work, a single operator could not respond to all booking requests within acceptable times.

In contrast to the rank and hail market, the phone booking market does not suffer from the same constraints to effective competition. Consumers — or at least more frequent users — do not face the same search costs: they can negotiate prices beforehand in an unpressured environment, seek price information from a range of companies or use a company which from experience they know offers a price and quality combination which meets their requirements. In this regard, hiring a taxi or hire-car by phone is not dissimilar to purchasing a range of other services commonly organised by phone, such as ordering home delivered pizza or engaging home handypersons.

In Australia, owing to entry restrictions, hire-cars tend to operate predominantly in the premium end of the phone market, but conceptually they are no different from taxis in responding to phone bookings. As the development of the United Kingdom mini cab industry demonstrates, without entry controls there would most likely be a wider range of hire-car operators offering both higher and lower quality levels than taxis presently offer.

Unlike the rank and hail market, there is not the same need for signage to identify a vehicle as a taxi or hire-car in the phone market since consumers do not generally need to distinguish the vehicle from other traffic.

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## 3 Assessing the need for existing regulations

The Competition Principles Agreement requires that the need for, and alternatives to, current regulation be considered in legislation reviews. Based on the characteristics identified in taxi and hire-car markets, this chapter discusses: the need for government involvement; whether existing regulatory regimes are the most efficient means to overcome perceived problems in taxi markets; certain key elements that underpin their impact; and regulatory options that could be considered as part of the legislation reviews.

### 3.1 Safety and quality regulation

As noted above, in all three market segments — rank, hail and phone — users have difficulty in assessing the safety and quality of service associated with a particular taxi. This may be less of a problem for frequent users who, over time, become familiar with (say) the calibre of the drivers and the cleanliness of vehicles attached to a particular taxi company. Nonetheless, with large numbers of individual taxi owners, significant variations in quality standards can exist, even between taxis in the same fleet. And even frequent users have limited capacity to assess some elements of safety and quality (eg the roadworthiness of the vehicle).

Mainly because of the limited information available to users (so-called ‘asymmetric information’), it is widely accepted that governments have a legitimate role to play in prescribing minimum safety and quality standards. The more contentious issue concerns, first, how these objectives are most efficiently pursued and, second, exactly what matters should be subject to government control.

To date, governments in Australia have sought to achieve desired safety and quality levels by regulatory means. In a number of other service industries, these objectives are pursued by industry codes or certification schemes, generally of a voluntary nature. In terms of the taxi industry, this could imply that, rather than promulgating compulsory standards through regulation, governments (or possibly private organisations) could offer voluntary certification to taxi operators. The level of

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certification achieved by each operator — which would presumably be publicly displayed by those achieving the highest levels — would help users to associate at least some aspects of safety and quality with individual vehicles. In some senses, this concept would be an extension of the present brand naming used by the larger taxi organisations in major cities to help establish a reputation for quality.

In principle, a ‘market-based’ scheme like this, or a variant of it, could overcome some of the disadvantages typically associated with regulation (eg the limited flexibility and incentives it provides to improvise and provide non-standard services). However, in practice, even if there was a high take-up, it is likely that significant information problems would remain for at least some users. For instance, some passengers that use taxis infrequently would be unlikely (or unable) to invest the time needed to understand the meaning of certification. Tourists, in particular, (both international and domestic) would not have the requisite local knowledge to determine quality on the basis of a certification scheme.

In this situation, some minimum level of regulation appears warranted.

At present, the broad framework of taxi safety and quality related regulation across jurisdictions in Australia is similar, other than in the Northern Territory (which has largely deregulated the industry). It encompasses regulation aimed at:

- consumer safety (eg roadworthiness tests, maximum vehicle ages and driver training requirements);
- driver safety (eg the provision of protective screens and in-cab cameras); and
- improving service quality (eg tests of drivers’ character, English language capability and geographical knowledge, and cab and driver presentation requirements).

The Commission supports the broad thrust of these current regulatory arrangements. However, in its view, the justification for some existing regulation is weak:

- it is not necessary to subject taxis to more stringent roadworthiness checks than other passenger motor vehicles. All vehicles — irrespective of whether they carry paying or non-paying passengers — should be subject to regulations designed to meet some government-specified minimum safety level. However, the large distances covered by taxis imply a need for more frequent inspections than would be the case for most other passenger motor vehicles;
- provided an adequate inspection process is in place, there is little need to prescribe a maximum age for taxis. Subject to them meeting safety and presentational standards, there seems to be no reason why vehicles older than current maximums could not continue to be used as taxis;

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- the grounds for currently prescribing minimum sizes for taxis are weak. In the absence of entry restrictions, it is highly unlikely that such regulation could be justified;
  - similarly, the case for requiring taxi drivers to undergo driver training additional to that required to obtain a conventional drivers licence is not strong; and
  - it is *possible* that driver dress rules and vehicle presentation standards could be justified on the grounds that individual drivers and vehicles that rate poorly in these areas generate spin-off effects that impact adversely on the industry as a whole (eg a tourist who engages a dirty cab may decide that taxis in general are not an appropriate means of transport in that particular city). However, the benefits from mandating *uniform* dress standards and vehicle liveries are problematic. For instance, some residents may perceive a common colour scheme within a city as an improvement. On the other hand, without adequate signage, a uniform colour could hinder the identification in the hail market of the company to which a taxi is attached and, thus, reduce competition.

## 3.2 Regulating entry

Arguments for restricting entry to the taxi (and hire-car) industry are often not well articulated but, in the main, have been based on enhancing safety and constraining fare increases.

### Objectives of restricting entry

#### *Taxi safety*

Taxi organisations and some governments argue that restricting the number of taxis on the road enables taxi owners to achieve a level of income sufficient to ensure that vehicles meet the prescribed safety standards. Increasing taxi numbers, it is argued, would result in falling incomes and a decline in maintenance and safety levels. (In the past, similar arguments were cited as requiring the maintenance of entry restrictions on intrastate aviation routes.)

The Commission does not find these arguments compelling.

The Commission acknowledges that there is a role for regulation in specifying minimum safety standards for taxis. This reflects the very limited ability of passengers to determine the mechanical condition of the taxis they use, as well as concerns about the safety of third parties. But the most efficient way to pursue

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safety objectives is by targeting them directly — not indirectly through income support measures. These latter measures provide no guarantee that safety will be improved. This is most evident in the case of leased plates where the higher income is appropriated by the owner of the plate, not the taxi operator — the person responsible for vehicle safety.

With well-targeted safety regulations — supported by an appropriate system of enforcement and sanctions — it is difficult to justify restrictions on entry in order to address safety concerns. This arrangement is similar to the existing requirements applying to private car owners — there is no requirement on individuals to demonstrate they have the financial wherewithal to maintain a car. Rather, they are subject to regulations that require cars to be roadworthy, including (in most jurisdictions) either periodic and/or ‘on the spot’ inspections.

### *Constraining fare increases*

Some economists (eg Schreiber 1975 and Teal and Berglund 1987) have argued that entry restrictions are necessary to guarantee the efficient functioning of the market. More specifically, they argue that price competition is unlikely among taxis because the nature of taxi markets means that an individual taxi decreasing its price may not lead to extra demand for its services. It is contended that, *if* taxis had no incentive to reduce prices, deregulating entry could lead to more cabs entering the market and, as a result, prices rising rather than falling as each cab attempts to cover its costs from the same pool of customers. Some critics use this form of reasoning to explain why prices rose in some United States taxi markets when they were deregulated (see box 3.1).

An argument along these lines *could* be plausible if taxi services were predominantly provided through the hail market. The claim would depend upon the notion that, largely because of the needs of those hailing a cab in the street, competition is limited in this section of the market. However, the rank and phone markets collectively represent by far the majority of business in most major Australian cities. In these markets there are few constraints to competition:

- there is the potential for some competition at ranks, especially when demand is relatively low. In a deregulated environment, consumers could compare prices (and possibly quality) and make choices accordingly. For instance, in New Zealand, entry is unrestricted and taxis offer different prices. As the New Zealand Transport Minister has stated:



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### Box 3.1 Taxi deregulation in the United States

A number of cities in the US deregulated their taxi industry in the 1970s. Although the reforms varied, in many cases entry, price and most quality controls were removed simultaneously. No special provisions were made for airports.

Following the changes, taxis numbers increased by between a quarter and a third. Most new entrants were single operators working mainly from airports and other ranks.

While there is little information about changes to response times of taxis or queuing times, there is considerable debate about what happened to fares. Frankena and Paulter (1986) and Doxsey (1986) claimed that, overall, fares decreased or remained constant — the exceptions being in areas where there was little or no competition and airports or hotels where single operators charged excessive fares. On the other hand, Teal and Berglund's (1987) much cited study suggested that average fares rose considerably.

Teal (1989) argued that, to solve the problems, all taxi operators should have to belong to an organisation which provides 24-hour radio dispatch services (rather than allow single operators). Another option suggested by Teal and Berglund was to eliminate all entry controls (except for quality controls such as safety regulations), but retain maximum fares. This would allow new entry, but protect consumers from excessive prices at airport ranks and the like.

The response of most US cities went well beyond that suggested by Teal — most re-regulated the taxi industry to overcome quality and, in some cases, pricing problems — particularly at airports. Often this involved re-imposing entry and/or price controls.

The US experience has been cited as a reason for not deregulating Australian taxi markets. However, Australian taxi markets differ significantly from the US markets in the 1970s:

- Teal and Berglund (1987) suggested that plate values were relatively low in the US and did not increase taxi costs significantly: hence, deregulating entry did not lead to large cost reductions and create much scope for price reductions. However, in Australia, licence values increase taxi operating costs by up to 30 per cent, indicating that there are significant benefits available to Australian consumers from deregulation. Even now a taxi licence in New York costs around \$US60 000, compared with values of well over \$A250 000 in major Australian cities (Staley 1998).
- Teal and Berglund suggested that a major impediment to competition was entry costs to the telephone order market. However, profound changes in telecommunications technology since the 1970s, and the evidence of new telephone dispatch services developing in the deregulated Northern Territory market, mean this is less likely to be a significant impediment today.

*Sources:* IC (1994), Teal and Berglund (1987), Frankena and Paulter (1986), Teal (1989), Doxsey (1986).

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I often hear people talking about taxi rides they have taken. Customers do remember which company has given good service.

Not only will they ring a particular taxi company they will also pick a particular taxi from the rank. Long gone are the days when you had to take the first taxi in the queue. (Williamson, M. 1998, Speech to the Taxi Federation Annual Conference, September)

- as noted in chapter 2, there is considerable scope for competition in the phone market. Consumers are more likely to have the time to establish relative prices and quality levels. And businesses and frequent users will often seek to identify the taxi company which best satisfies their needs.

These considerations suggest that, if given the opportunity, users will discriminate between taxis on the basis of price. In response, in the more competitive environment that would result from the lifting of entry restrictions, there would be pressure on taxi operators to reduce, rather than increase fares, to gain market share. The Commission does not consider that entry restrictions are necessary to constrain fare *increases*. Instead, removing entry restrictions is likely to provide greater pressure for fare *reductions* than exists at present.

The argument that entry restrictions are necessary to constrain fares is also at odds with the experience of deregulation in New Zealand and the UK mini-cab industry. In New Zealand, brand naming has become increasingly important since deregulation in 1989, and has been accompanied by reductions in fares. Similarly, there is price competition in the mini-cab sector of the UK market where entry is not restricted. Thus, while the United States experience may caution against complete deregulation of the industry, it does not provide evidence to support the view that, in Australia, taxi markets could not function effectively without entry restrictions.

### **The costs of restricting entry**

While entry restrictions seem to provide few benefits to the community, they have the potential to impose costs on users.

The limited available information suggests that the restrictions have artificially suppressed the number of taxis. For instance, whereas there are between 0.77 and 1.14 taxis per thousand people in Australia's state capital cities, in the deregulated Auckland and Wellington markets there are over double that number (2.93 and 3.66 taxis per thousand people, respectively) (IPART 1999, p. 75). Other factors (eg the availability of other forms of public transport and fare relativities) associated with the New Zealand markets may impair the comparison. Nonetheless, the magnitude of the differences in taxi numbers suggests that the removal of entry restrictions in

Australian markets would be accompanied by an appreciable increase in the number of taxis.

Restricting the number of taxis on the road allows each taxi to earn higher profits than it otherwise would. These profits, which correspond to a direct cost to consumers, can arise in two ways. The first, and most obvious, is in higher fares (which, under the present arrangements, are possibly most evident in the very limited extent of discounting). But entry restrictions also allow taxis to earn higher revenue by being engaged for a greater proportion of time than they otherwise would. That is, there is a faster turnaround time between jobs. However, this represents a cost to consumers in the form of longer queues for taxis and a slower response to phone bookings. At peak times and at some high demand ranks, like at major airports, these costs can be high.

The capacity of taxis to earn higher than normal profits under the existing arrangements is reflected in the high sale value of taxi plates — currently between \$260 000 and \$280 000 in Sydney (see table 3.1 for values in other capital cities). This value reflects a combination of:

- the excess profits a taxi can earn;
- a related factor, the expected appreciation over time in plate values (which is a reflection of expected increases in lease values); and
- possibly goodwill and a value that some owner-drivers place on having ‘secure’ employment (see box 4.1 in section 4 for a discussion of plate values).

**Table 3.1 Real cost of taxi licences in each jurisdiction <sup>a</sup>**  
Thousands (\$)

<i>State</i>	<i>1991</i>	<i>1992</i>	<i>1993</i>	<i>1994</i>	<i>1995</i>	<i>1996</i>	<i>1997</i>	<i>1998</i>
NSW	199	224	223	218	235	Na	284	260 <sup>b</sup>
Vic	133	145	134	162	188	Na	264	265
Qld	172	195	196	192	186	Na	259	267
SA	104	126	140	153	148	Na	157	158
WA	166	157	156	158	183	Na	233	210
Tas	66	65	75	71	75	Na	101	100
ACT	235	261	317	311	251	Na	244	280
NT	149	169	189	186	230	Na	249	230

<sup>a</sup> Licence values have been adjusted for inflation to 1998 dollars.

<sup>b</sup> A more recent study (IPART 1999) cites a value of \$280 000

Source: Soon 1999a.

Rather than own a licence, many operators lease plates, typically for a period of two years. The lease cost provides the most accurate estimate of the additional cost to consumers from entry restrictions. Lease values are determined by the market and,

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hence, reflect the return a plate owner can expect purely from owning the plate. According to the IPART interim report, lease values are around \$18 700 a year in Sydney. Given that there are around 4500 licences in Sydney, this is equivalent to an annual cost to Sydney taxi users of over \$75 million.<sup>1</sup>

Taxi plate costs comprise a significant proportion of total taxi costs — approximately 25 per cent according to IPART’s calculations. Thus, assuming no other change in the industry, eliminating the licence value could result in fares falling by up to 25 per cent, an increase in the number of taxis on the road (and, thus, shorter waiting times), or a combination of both. As IPART said:

If this value could be eliminated, the same level of taxi availability could be achieved at a lower fare level. Alternatively, at the same fare level, taxis could tolerate more vacant time and hence taxi availability could be improved. In a fully deregulated industry, the market would set the balance between taxi fares and availability. (IPART 1999, p. 77)

Whichever way the benefit from liberalisation is delivered, it can be thought of as a transfer of approximately \$75 million a year from plate owners back to existing consumers. Additional benefits would accrue from an expansion in the demand for taxi services. At present, high prices deter some people from using taxis or using them as often as they otherwise might. Excessive queuing or slow response times during peak periods are also likely to deter some people from using taxis (eg because of the difficulty of securing a taxi on a Friday night, some people may take their own car or switch to public transport). While these benefits are hard to measure (see box 3.2), they represent a direct efficiency gain that is lost under the current arrangements.

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<sup>1</sup> According to IPART (1999, p.75) there are 3933 standard taxi licences, that would have a lease value of \$18700 a year. The remainder comprise wheelchair accessible taxis and peak availability licences which would have a lower lease value.

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### Box 3.2 Measuring the benefits of taxi deregulation

Estimates of the loss of consumer surplus and the deadweight losses of taxi regulation are sensitive to the extent to which the regulated fare exceeds the competitive fare. An Australian study by Gaunt and Black (1996) attempted to measure the transfers and costs associated with regulation of the Brisbane taxi industry. The authors concluded that, in 1993, taxi regulation had resulted in a Brisbane taxi plate having a value of \$190 000, reflecting 228 fewer cabs than would arise under a competitive regime and an increase in fares of \$1.47 for a standard 8km trip. Gaunt and Black (p. 57) concluded: 'The public or consumer interest has suffered an estimated \$20.67 million annual loss of wealth in 1993, while between \$11 million and \$19.1 million of this loss has been picked up by the politically powerful licence holder lobby and between \$1.48 million and \$9.55 million has been lost to society with no group directly benefiting [the deadweight loss]'.

*Source: Gaunt and Black (1994).*

Finally there could be further benefits from deregulating entry associated with efficiency improvements over time (often termed 'dynamic efficiency'):

- Firstly, a wider range of vehicles could supply taxi services, including smaller vehicles in niche markets or mini-buses that carry a greater number of people. Smaller vehicles have lower operating and capital costs, while mini-buses allow the capital to be used more intensively. Both outcomes could lead to lower fares.
- Secondly, innovative ways of overcoming peak demand problems are more likely to emerge. One possibility is that part-time taxis would enter the market. These cars would operate as private vehicles at off-peak times, but could be used as taxis or hire-cars at peak times. Again, this could reduce costs and result in lower prices. Current entry restrictions deter such behaviour because the high cost of plates tends to force operators to run vehicles for most, if not all, of the day in order to cover costs. (In some cities (such as Sydney) this problem is addressed to some degree through the availability of some licences for use only during peaks.)

In summary, deregulating entry is likely to lead to significant benefits being transferred from licence holders to consumers, and significant efficiency gains for both the industry and consumers.

Studies of the use of taxis show that, while use increases with income, low income earners who are unable to afford a car spend the greatest proportion of their incomes on taxis (IC 1994). For instance, Soon (1999b) found people in the lowest 20 per cent of household incomes spend 0.68 per cent of their income on taxis, while those

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in the highest 20 per cent spend 0.17 per cent. Thus, the costs of entry restrictions are borne most heavily by those who are less well off. The removal of entry restrictions would, therefore, overcome the regressive impact of the current arrangements and could be seen as desirable on equity grounds.

**The Commission does not consider entry restrictions are needed to constrain fare increases, to underwrite the safety of taxi users or to promote other aspects associated with the efficient provision of taxi services. In the Commission's view, the removal of entry regulations would offer large benefits to the community.**

In all states and territories except South Australia, entry to the hire-car market is also restricted. A factor motivating governments in regulating hire-cars appears to be the recognition that policies of restricting entry to the taxi industry would be undermined if there were free entry to the hire-car industry. If entry restrictions for taxis were removed, this rationale for maintaining entry restrictions on hire-cars would obviously disappear. That said, if the taxi industry were to be deregulated, the inter-relationship between the taxi and hire-car industries would need to be taken into account in order to allow a smooth transition.

### **3.3 Fare regulation**

Except in Victoria, taxis operate under a maximum fare regime rather than a prescribed rate. However, in effect, there is no price competition as all cabs tend to charge the maximum allowable fare.

There are two commonly espoused alternatives to maximum fare regulation in a deregulated environment: full deregulation, whereby passengers negotiate fares for each journey; and posted prices, whereby taxi companies set their own prices in advance and are required to 'post' them both outside and inside their vehicles. Posted prices could vary according to the time of day and/or the location of pickup or drop-off.

Debate about the appropriate level and form of price regulation for the taxi industry raises a number of complex issues. And, as illustrated in the following discussion, the rationales for regulating fares are different in the rank and hail (or cruising) market and the phone market. The discussion presumes that entry restrictions would be removed.

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### *The rank and hail markets*

In the hail market, the relatively weak bargaining position of users tends to suggest that, at least in periods of peak demand when choice is limited, fully deregulated fares may not lead to good outcomes for the community. For example, prices could be inflated to exorbitant levels when it rains and there are few available taxis. This problem could be magnified in situations where users are unfamiliar with usual fare structures — for instance, in tourist areas.

One alternative to full deregulation is the approach adopted in New Zealand. In that country, taxis are required to post their prices inside and outside their vehicles. They are also required to notify the Government in advance of changes to posted prices.

There are a number of attractions of such a system. For example, posted prices:

- allow companies to compete by offering different combinations of price and quality of service;
- would eliminate the ability of taxi drivers to make ‘on the spot’ decisions to charge excessively high prices in situations when demand is especially high. However, it would not preclude time-of-day charging whereby prices would be routinely lower in off-peak times and higher when demand was greatest; and
- would eliminate the need to ‘haggle’ over prices at taxi ranks — which may not suit consumers and could lead to overly aggressive solicitations for fares by drivers.

However, posted prices may not be appropriate for all situations. At major airports — where passenger volumes are high, luggage has to be loaded and some passengers are fatigued and not familiar with usual fare structures — it is a practical necessity to conduct transactions quickly so as to minimise queuing times. For instance, IPART notes that Sydney Airport aims for taxis to load and dispatch passengers in one minute. In these situations, the ‘first cab off the rank’ system may not just be a cultural convention — it may also be the most efficient option from a logistics point of view. However, enforcing a ‘first cab off the rank’ regime precludes consumers from choosing among cabs at the rank. Consequently, taxis with higher than average posted prices would still be assured of gaining airport trade. Over time, this could encourage a range of ‘rogue’ cabs to post high prices and concentrate predominantly on the airport rank. This would be unreasonable for those passengers forced to use these higher charging cabs.

Faced with these types of problems (and conflict between drivers), the New Zealand Government has re-regulated the Wellington airport rank via entry restrictions to allow only ‘reputable’ companies to pick up at the airport. However, limiting the

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number of cabs that can service the airport represents a partial restriction on entry and could perpetuate, to some extent, airport queuing problems.

In these circumstances, for the foreseeable future at least, there appears to be grounds for some form of price regulation of taxis that results in a uniform fare structure applying to serving the main rank at major airports.

It is possible to envisage solutions to the airport problem that allow both price competition and quick turnarounds. One alternative that has been adopted in a number of countries is to physically separate vehicles offering different qualities of service. Thus, while the main airport rank could comprise taxis that operate under a uniform fare structure, there could be an area for small or lower quality vehicles that charge lower prices, as well as an area to provide higher quality services (limousines, hire-cars etc). The availability of these different types of services, indicative costs and their departure points would need to be clearly indicated by signs in airport arrivals areas.

#### *The phone booking market*

Unlike the rank and hail markets, conceptually there is a less compelling case for setting prices in the taxi phone market. Taxi users making bookings by phone have lower search costs, can choose between taxis and hire-cars and, as they are not in a position of having to take the first available cab, they are less vulnerable to drivers who wish to exploit acute shortages that may occur during peak times.

There is already evidence of forms of competition in the phone market. For example, in major Australian cities the expansion in mobile phone use has facilitated the development of sub-networks within taxi companies, whereby groups of drivers offer a 'premium' service (at the normal taxi rate) to attract repeat business from regular taxi customers. This type of brand naming for quality or price would become more common with the removal of entry restrictions.

#### *A mixed regime?*

If entry restrictions were removed, functional differences between the major market segments suggest that, in principle, three different fare regimes could be contemplated for taxis:

- uniform fare regulation at major airports;
- posted prices in the rest of the rank and hail market; and
- no fare regulation for phone bookings.



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A mixed regime along these lines would target regulation to where it was necessary, while offering maximum freedom to operators and customers to negotiate where there is not a significant imbalance in bargaining power. However, in practice, such a mixed fare regime — overlaid with charges that could potentially vary for different periods in the day — is likely to be complex, costly to administer and confusing to consumers. In addition, such a mixed regulatory regime encompassing different levels of regulation in markets that are close substitutes can in itself lead to resources being misallocated (eg artificially diverting demand from the cruising to the phone market).

### *The preferred option*

Based on existing regimes in Australia and overseas, more practical approaches to regulating fares are a posted price system or a deregulated regime, with a regulated fare applying, where necessary, at major airports. With each of these alternatives, a regulated maximum fare could apply if there is considered to be a need to restrain overall prices.

The choice between these alternatives will be influenced by the nature of the market. For example, in cities where a large proportion of business originates from ranks, a posted fare regime could be the most attractive option. On the other hand, in smaller markets where the majority of business is via phone bookings, users are less vulnerable to exploitation and a deregulated approach could be appropriate.

**In major cities, posted prices, coupled with a fixed airport fare, may be appropriate. In smaller cities, with a strong phone booking market, fully deregulated fares should be considered.**

In the longer term, competitive pressures are likely to reduce the need to maintain maximum fare regulation (other than at some major airports), unless price gouging becomes a problem in a deregulated market. However, the Commission considers that there is a strong case for maximum fare regulation during the transition to unrestricted taxi licences. More specifically, there would be significant risks in removing maximum fares before entry is fully deregulated. If fares were deregulated, but the number of taxi plates were still restricted to some extent, it is possible that fares could rise above present levels. This could occur sporadically or, if the relaxation of entry restrictions was gradual, could continue for some time until the increase in the number of licences was sufficient to temper fare increases.

The retention of maximum fares during the period in which entry restrictions are removed would not necessarily lead to the uniform charges which presently characterise taxi markets throughout Australia. With a larger number of taxis

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competing for business, there would be a greater likelihood of price competition. The regulated maximum fare would probably remain the ‘standard’ fare, but it could also be the benchmark from which discounts are offered. For instance, companies could compete on price to secure a larger customer base by:

- offering permanently discounted fares, either all day or during specified off-peak periods;
- negotiating discounts with major customers; and/or
- offering (and advertising) pensioner or welfare recipient discounts and the like to capture more price-sensitive customers.

A possible objection to maximum fares is that it could preclude suppliers offering higher quality services. This would certainly be a problem if the regulatory distinction between hire-cars and taxis were abolished (eg if hire-cars were subject to the maximum fares applying to taxis). However, as long as hire-cars — operating in the phone market — could offer whatever price and quality combination they wished (including premium services), setting maximum fares for taxis would not unduly restrict the range of services available to consumers.

**The Commission considers that maximum fares should be retained during the transitional period to open entry.**

### **3.3 A different regulatory regime for hire-cars?**

At present, hire-cars are regulated under a separate regime to taxis. Fares are not regulated, but there are two forms of entry restriction. First, there are restrictions on the total number of hire-cars and, second, hire-cars are not permitted to compete with taxis in the cruising market.

Under these arrangements, other than in Adelaide, competition from hire-cars has had limited impact on the taxi industry, largely owing to the restricted number of hire-cars. For example, in Sydney, there are only 240 unrestricted hire-car licences — equivalent to about 5 per cent of the number of taxi licences. Hire-cars tend to offer premium services using more expensive models of vehicle. However, if entry is deregulated, then, based on the experience in Britain where the rival mini-cab industry now offers both high and budget quality services, competition with taxis would almost certainly increase. Indeed, Radbone (1998) suggests that, in the absence of regulatory restrictions, hire-cars could outnumber taxis in South Australia within ten years.

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An argument in favour of abolishing the distinction is that the distinction is artificial — both taxis and hire-cars provide similar and competing services and should, therefore, be regulated in the same way. Hire-cars could then compete alongside taxis in the rank and hail market if they wished.

In the longer term, the Commission sees little reason for retaining the distinction. However, it recognises that, as a transitional measure, there could be grounds for continuing the restriction on hire-cars competing in the rank and hail market. For one thing, permitting hire-cars to compete in these markets would add to adjustment pressures. For similar reasons, the lifting of restrictions on the number of hire-car licences would need to be linked to the time period over which the entry restrictions applying to taxis were removed (see chapter 4).

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## 4 Compensation and adjustment assistance

Concomitant with proposals for the deregulation of the taxi industry is the need to consider two important implementation issues — adjustment assistance and compensation. This chapter explores some of these issues, including:

- the form, rationales and the relationship between adjustment and compensation;
- adjustment and compensation issues specific to taxi deregulation; and
- practical considerations associated with compensation (eg design criteria such as targeting).

### 4.1 Some general principles

In principle, a distinction can be drawn between adjustment assistance and compensation in terms of their underlying rationales. Adjustment assistance is commonly viewed as a measure that seeks to facilitate adjustment to new circumstances, whereas compensation is a form of restitution for losses arising from government action. However, in practice, it sometimes can be difficult to discern whether government action is more accurately portrayed as compensation or, alternatively, adjustment assistance. In large part, this is because the two measures are not mutually exclusive — for example, compensation payments can also help individuals to adjust to changed circumstances.

#### Compensation

In its simplest form, compensation involves cash transfers to the ‘losers’ of a policy change to restore, or partially restore, their pre-reform position (ie wealth situation).

From an efficiency perspective, some argue that there is no case for compensation because it erodes the benefits of reform (eg it can give rise to losses associated with raising additional tax revenue). In contrast, others consider that failure to compensate for major policy changes can undermine investor confidence and lead to intensified efforts by vested interests to seek to have reforms stopped.

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In practice, public policy decisions encompass considerations that extend beyond efficiency criteria to include notions of equity and ‘fairness’. For instance, when a policy change imposes substantial losses that are concentrated on relatively few individuals, it is often regarded, in the absence of compensation (restitution), as unfair, even though the change may bring about net benefits for the wider community.

## **Adjustment assistance**

The term ‘adjustment assistance’ is commonly used to describe a broad family of policy instruments which aim to help individuals and firms adjust to changing circumstances.

Adjustment assistance is underpinned by the social ‘safety-net’, which includes long standing arrangements to provide income support for disadvantaged people in the community and those suffering hardship (eg unemployment and carer’s allowance, and labour market measures). The ‘safety net’ is the first, and often only, port of call for many individuals adversely affected by change (whether policy or market induced).

One form of adjustment assistance, which has been used widely in the past, is the phased implementation of reforms (in effect, tapered support). Phasing has often followed advance notice of the policy change.

Adjustment assistance can also include initiatives tailored to meet the specific circumstances of individual reforms, such as industry plans or region-specific training initiatives. Specific adjustment assistance is more likely to be warranted if the effects of the reform are large and are concentrated in vulnerable regions where the scale of the ‘shock’ is likely to have a powerful ‘knock-on’ impact that could lead to regional decline, and/or the activity subject to reform displays ‘problem’ labour market characteristics (eg a predominance of older workers or people with specific and non-transferable skills who may require retraining).

The taxi industry does not closely mirror these characteristics. It operates mainly in larger more diversified population centres, where it represents a small fraction of total activity. Moreover, the adjustment costs from deregulation would be borne by those who own taxi licence plates — ‘pure’ investors and owner-drivers — rather than the majority of drivers who operate taxis with leased plates and the many part-time drivers. Indeed, deregulation is likely to result in employment opportunities within the industry expanding rather than contracting.

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Nonetheless, given that the taxi industry and consumers have over many decades become accustomed to operating within a tightly regulated environment, there could be a case for some adjustment assistance — in the form of advance notice and phased implementation of reforms — to facilitate the orderly transition to a deregulated environment.<sup>1</sup>

The following discussion focuses on the more contentious question of whether compensation should be provided to the ‘losers’ of deregulation of the taxi industry.

## 4.2 Compensation for taxi deregulation

The value of taxi licence plates on the open market varies between cities, but is typically over \$200 000 — for example, around \$280 000 in Sydney and the ACT and \$350 000 in areas of the central coast of New South Wales (FRG 1999). While opinions vary about the extent to which taxi plates embody a monetary component for ‘goodwill’, their value is essentially a reflection of scarcity created by the entry restrictions to the industry (the so-called ‘quota rent’). Thus, the value of taxi plates could potentially fall substantially — possibly to zero — if entry restrictions were abolished.

The case for compensating incumbent plate holders for the diminution in the value of their asset is complex. Factors which bear on the decision whether or not to compensate include:

- whether governments should protect the value of those ‘property rights’ which owe their existence to regulation;
- whether policy actions that leave some individuals significantly worse off are inherently unfair and require restitution; and
- broader considerations such as the ability to progress some reforms more readily if accompanied by compensation, and also the down-sides of such an approach.

These factors are discussed, in turn, below.

### Property rights-based arguments

A key issue relates to the status of the ‘property right’ created by government restrictions on taxi licences.

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<sup>1</sup> To the extent that any compensation is provided to offset the losses experienced by licence holders, there should be an attendant reduction in the phasing timetable (see section 4.3).

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In some areas, individual's property rights — and compensation rights — are well defined. However, in many areas they are unclear and, ultimately, claims need to be resolved by the courts. For example, under the Australian Constitution, landowners have a Constitutional right to 'just compensation' should their land be compulsorily resumed.<sup>2</sup> However, other government actions can also affect land values, including changes in zoning and land use regulations, without attracting compensation.

A taxi licence is an asset that has been created by an explicit government policy that is intended to provide the community with taxi services which are efficient, safe, affordable and of an appropriate quality. While the factor from which the value of the licence stems — the entry restrictions — may not be essential to the achievement of these objectives, it has been an integral element of taxi regulation throughout Australia. Nonetheless, it is difficult to say that measures used to pursue these objectives came with a guarantee that they would continue in perpetuity. Indeed, all governments have periodically increased the number of taxi licences (which has resulted in changes to plate values), although often the increase has been in line with (or less than) population growth.

In ascertaining whether landholdings have a different status from ownership of a taxi licence plate, one view, summarised by the following legal reasoning from the United Kingdom, is that:

Property rights arising in licences created by law (enacted or delegated) are subject to the conditions created by law and to an implied condition that the law may change those conditions. Changes brought about by law may enhance the value of those property rights (as the Regulations of 1978 enhanced the value of taxi plates by limiting the numbers to be issued and permitting their transfer) or they may diminish them ... But an amendment of the law which by changing the conditions under which a licence is held, reduces the commercial value of the licence cannot be regarded as an attack on the property right in the licence — it is the consequence of the implied condition which is an inherent part of the property right in the licence (from *J. Costello in Hempenstall et al v The Minister for the Environment* (1992) quoted in *Kenny and McNutt* 1998).

This legal reasoning implies that the property right status of a taxi licence is a consequence of its conditions, which governments have a right to vary. Put another way, this is analogous to stating that sovereign risk in such situations should not be regarded differently to market risk. On the other hand, the actions of some governments in auctioning licences or allowing them to be traded could be

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<sup>2</sup> Interestingly, state Constitutions do not provide for compensation for compulsory acquisition of property (Walsh 1999).

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construed as a governmental imprimatur for recognition of their value and status as a property right (like land).<sup>3</sup>

In Australia, governments have not reacted in a consistent fashion to situations in which they have created ‘property rights’ and then subsequently eroded their value or removed them. For instance, when the egg industry was deregulated in New South Wales, compensation for the loss of value of egg quota holdings was paid to egg producers. Recently, the Commonwealth Government announced compensation for dairy farmers as part of a deregulation package that will, among other things, devalue market milk quotas. On the other hand, removal of licences held by importers for a range of quota protected manufacturing goods has not generally been accompanied by compensation. Indeed, many other activities subject to reforms which have devalued or removed rights have not been compensated — for example, the loss of income for members of the legal profession when some governments removed their exclusive right to engage in conveyancing of property.

A case for compensation is strongest where Constitutional rights are involved and where governments have entered into a specific contract to do so. For example, Forsyth (1999) reports that ‘in Victoria, the state government has contracted to compensate the private developers of the Citylink toll road should it [the Government] make transport investments which reduce the demand for the toll road’. In this instance, there is a *specific* rather than an *implied* contract. However, in the absence of this type of arrangement, there is no clear cut rule as to when compensation does, or does not, apply if government action erodes the value of government created ‘property rights’.

Aside from property rights, the consideration of compensation can also hinge on notions of fairness and, at times, pragmatism (eg a need to ameliorate opposition to unpopular, but beneficial, reforms). These issues are outlined below.

## **Fairness and equity arguments**

If a policy change imposes disproportionate losses on a minority of individuals, it can be regarded as ‘inequitable’ or ‘unfair’ and warranting compensation. Equity is usually raised as a concern if a particular reform will have a regressive distributional effect — such as a policy initiative which delivers significant gains to the wealthy and imposes large adjustment costs on less well-off people. Fairness, on

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<sup>3</sup> Had licences been issued at an administrative cost and been non-transferable, a case for compensation would be unlikely to arise (albeit that, if permitted, a leasing market would still reflect the quota rent). In this situation, deregulation could be seen as an ‘offset’ to the windfall gain that the original licence holders benefited from when governments granted them licences.



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the other hand, tends to be a more flexible notion which can vary markedly depending on a person's 'values' — for example, a reform which subjected a group of individuals to large, unexpected and uncompensated losses would be regarded by many as 'unfair', even if it redistributed income from (say) two-income households to a group of disadvantaged individuals.

As the case for compensating the losers of reform can vary depending upon the circumstances of different groups affected by change, it is useful to consider the broad structure of the taxi industry.

The three most relevant sectors of the taxi industry for this purpose comprise:

- 'investors' — those who have little involvement in the industry other than leasing their plates;
- owner-drivers — plate owners who also drive taxis; and
- lessee-drivers — drivers who lease the plates from owners.

Although this is a simplification of the industry's structure (it sets aside the role of taxi companies and co-operatives, taxi networks and operators of taxi businesses), it is useful in assessing the impact of reform on different participants.

The proportion of participants in each of these broad categories varies between cities. For example, around 80 per cent of plates in the Darwin area were owned by investors with no other direct involvement in the industry. In Sydney, IPART (1999) reports that a much smaller proportion — approximately 50 per cent — of licence owners are investors who lease their plates to taxi companies.

The values stemming from barriers to entry in the taxi industry are appropriated by licence plate owners — that is, investors and owner-drivers.<sup>4</sup> Lessee-drivers have no claim over the value of the plate, but they do have to cover the costs of leasing the plate. Thus, they would not experience a capital loss if the entry restrictions were lifted and plate values fell.

Although detailed information is not available to the Commission, in some cities large investors hold multiple plates. Given this structure, it is valid to question whether 'professional' investors — those that lease a number of plates — should be expected to better understand the risk associated with the asset and have a stronger financial capacity to 'wear' that loss. Argy (1998), for example, considers that the case for compensation is stronger when the change is an unexpected breach of long standing tradition and those who are hurt are relatively poor.

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<sup>4</sup> Much of the 'quota rent' in taxi licences could also be appropriated by governments if they auction new plates.

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It is also pertinent to consider the differential impact of deregulation upon new plate holders, who paid current market prices to enter the industry, versus long term incumbents (LTIs) in the industry — many of whom would have received a ‘freely allocated’ plate. ‘Newcomers’ would unequivocally be worse off following deregulation. For the LTIs, it may be argued that, depending on their time of purchase and the price they paid, they could have paid off their initial investment and are facing the loss of a potential capital gain rather than realising a capital loss.

In discussing fairness, it is necessary to extend the discussion beyond what is fair for the ‘losers’ of reform. Governments also have an obligation to the ‘losers’ of restrictive licensing — the taxi-using public. Compensation (funded by users) and phasing extend the duration of consumer losses. Further, as outlined previously, studies indicate that taxi industry regulation is particularly regressive — thus, the poor are the most disadvantaged.

In determining fairness, it is also relevant to consider parallels with other situations where government actions have disadvantaged regions, firms or individuals.

### **Broader considerations**

Instances of reform where compensation is not a normal part of policy include:

- the removal of cross subsidies which have advantaged some users of goods and services supplied by government business enterprises (eg subsidised rail freight);
- the devaluation of farm infrastructure investments as a result of initiatives to move toward full cost pricing for irrigation water;
- reductions in tariffs and local content schemes that effectively devalue sunk assets (eg textile plant and equipment);
- deregulation in other areas of licensing and quantitative restrictions (eg poker machine restrictions and opening up competition in the professions); and
- changes in superannuation.

Drawing up decision rules to discriminate between those losses that warrant compensation and other losses is complex. In practice, they may not lead to consistent treatment across activities. This is highlighted by the divergent approaches adopted by governments in relation to taxi deregulation. For example, in the Northern Territory, a ‘full compensation’ package was introduced at a cost of

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around \$27 million. On the other hand, in New Zealand, sweeping taxi industry reform was introduced without compensation.<sup>5</sup>

The IPART interim report does not examine the issue of compensation. Indeed, a stated objective in that report is not to erode the value of existing licences too quickly. This may be based on a view that a long phasing period can obviate the need for compensation. However, phasing, of itself, provides only partial, tapered compensation (unless it is over a very long time frame). A formal announcement of a more liberal regime in the future, with or without phasing, would have an immediate negative impact on licence values.

Finally, it needs to be recognised that payment of compensation in one area could promote expectations for like treatment in other areas of reform, even to the extent of seeking compensation for market-, rather than policy-induced, change. This could encourage others facing losses to agitate for compensation, thereby stalling some reforms or forcing the introduction of modifications which reduce the benefits. In addition, ‘rent-seeking behaviour’, leading to excessive resources being diverted to lobbying, would be encouraged — an unproductive activity from a national perspective.

**Whether and what level of compensation should be paid depends on assessments by governments of a range of matters such as equity, perceptions of fairness, the possibility of reform not proceeding in the absence of compensation and the nature of the taxi industry in each jurisdiction.**

On the basis that some governments may (as happened in the Northern Territory) elect to provide compensation in deregulating the taxi industry, the next section discusses the appropriate amount of compensation and how it could be delivered.

### 4.3 How much compensation?

If compensation were to be provided as part of taxi industry reform, key considerations that bear on the amount of compensation are:

- the extent to which licence values derive from regulation;
- compensation package design issues (eg who should be compensated and by how much); and
- any accompanying phasing of reform and its duration.

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<sup>5</sup> It should be noted, however, that the value of taxi licence plates in New Zealand were much lower (around A\$20 000–25 000) than in Australia.

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A starting point for an assessment of the appropriate level of compensation is the value of the asset that is ‘at risk’ and the factors from which this value is derived.

## **The value of plates**

In broad terms, the market value of plates reflects the present value of expected future excess profits from a constrained competitive environment. However, it is possible that not all of the value of the licence reflects the scarcity rent from entry barriers. For example, IPART considers that a significant proportion of a New South Wales taxi licence — \$120 000 to \$180 000 — is made up of ‘goodwill’. This implies that the scarcity value of a licence from restricting entry is of the order of \$100 000 to \$160 000.

If these data are correct, licences would retain a value of over \$100 000 in the face of full deregulation. This would significantly reduce the cost of any compensation package. However, the Commission does not agree with these estimates (see box 4.1). It considers that the price of a taxi licence essentially reflects its scarcity value.

## **Compensation design issues**

### *Funding*

A compensation package may be constrained by the projected costs. For instance, the compensation package for the Northern Territory taxi industry cost around \$27 million, with compensation based on the last tendered price of a taxi licence in a particular area plus CPI. This was effectively a current market value approach which would cost well over \$1 billion in Sydney alone. Apart from absolute cost considerations and an assessment of equity between licence holders and the taxi-using public or taxpayers more generally, the mechanism for funding compensation is also contentious. The two major forms of funding compensation — from beneficiaries (ie taxi users) and/or taxpayers — are discussed below.

### *Beneficiary pays funding*

A beneficiary pays approach involves compensation being paid by those who stand to benefit from reform — in this case, taxi users. This could take various forms such as, for example, a levy on taxi journeys or an increase in licence fees — both of which would be passed onto users.

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#### Box 4.1      **Licence plate values: what do they comprise?**

An issue in determining compensation is whether the whole plate value, or only a part, is attributable to the returns a licence generates. The excess returns arising from the entry restrictions not only provide an indication of the losses that would be experienced by plate holders, but also the minimum level of benefits to consumers from deregulating entry.

IPART suggests licence values of \$280 000 in Sydney are a *combination* of goodwill and economic rent. About \$120 000 to \$180 000 is said to reflect goodwill, with the remaining \$100 000 to \$160 000 arising from the scarcity value from restricting entry.

The Commission considers that, while some taxi operators may earn returns that reflect goodwill, it is likely that this is through superior driver service rather than any inherent goodwill attaching to the plate. Goodwill is an intangible asset separate from the value created by the licence restriction. Thus, it would exist even if there were no entry restrictions. Indeed, if plates were freely available, why would anybody pay goodwill to obtain one? The Commission considers that the profits that IPART suggests are goodwill are really a reflection of higher prices and/or greater occupancy rates resulting from the restriction in licence plates.

The best indication of the annual return purely attributable to the plate is its lease value — \$18 700 in Sydney. This is also the best indication of the transfer of costs from consumers to plate owners caused by the restrictions.

An income stream of \$18 700 does not equate to a value of \$280 000 except at low discount rates (6.7 per cent *in perpetuity* — equivalent to the current long term bond rate, which involves no risk). However, two factors may explain why plate values in Sydney are higher than the *present* lease values would suggest should be the case:

- Firstly, investors could reasonably have an expectation of increases in lease values in the future (which can manifest itself over time as increases in the value of the plate — in much the same way as the value of a share on the stock market may rise based on future expectations).
- Secondly, owner-drivers may be willing to pay more for a taxi plate than could be justified purely in investment terms because they consider that plate ownership guarantees them employment and control over their work ('buying a job').

Importantly, the composition of plate values appears to differ among jurisdictions. In Canberra, plates also trade for around \$280 000, but lease for \$26 000 a year. An income stream of \$26 000 explains a much greater proportion of the licence value than in Sydney. Correspondingly, there appears to be a lower expectation of increases in lease rates in Canberra.

Sources: IPART 1999; FRG 1999 and Commission estimates.

The latter approach was adopted by the Northern Territory Government which provided an up-front compensation payment (from the budget) that will be recouped (in around nine years) through taxi (and hire-car) licence fees. This approach

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imposes (continuing) costs upon users — such as lower consumption and higher prices than would otherwise be the case.

Compensation delivered in this form represents an up-front payment to plate holders of the capitalised value of the stream of transfers from consumers. Thus, consumers would continue paying these transfers up until the compensation package was fully funded, but, assuming the supply of taxis increased, some benefits (eg reduced queuing, more product innovation and consumer choice) would commence immediately.

The extent and timing of price benefits for consumers is dependent upon the nature of the measures to recoup the cost of the compensation package. For example, if compensation is funded through licence fees, a fee set between zero and current market lease rates for taxi plates would be expected to deliver some early price benefits, but the full price benefits would not eventuate until the compensation was fully funded and the licence fee ‘surcharge’ removed. Conversely, a fee set higher than market lease rates would initially increase fares, but the transition to a deregulated price would be achieved more quickly.

If compensation is funded through higher licence fees, it is important that the cost of new licences not reduce the demand for licences to the point where licence revenues are insufficient to fully fund the compensation package (except over a very long time frame) or that they represent an unduly high barrier to entry.

#### *Taxpayer funded compensation*

Another approach would be to fund compensation from general government revenue, thus spreading the costs of a compensation package over taxpayers (including, of course, those who may not use taxi services). Like the beneficiary pays model, compensation would represent an up-front (or perhaps staged) payment from the government to plate holders. In this case, taxi consumers would derive immediate price benefits.

Under a taxpayer funded compensation model, apart from the opportunity cost of revenue transferred to licence plate holders (ie money no longer available for other goods and services such as health care), governments would need to be mindful of the so-called ‘deadweight’ costs of taxation.

The deadweight cost of taxation is a measure of the losses incurred by producers and consumers (including losses in ‘well-being’), over and above the tax raised.<sup>6</sup>

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<sup>6</sup> That is, consumers consume less of the taxed good and pay more for it, and producers receive a lower profit on a lower volume of output consumed.

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Albon (1997) estimates that this ‘efficiency’ cost, from combined Commonwealth and State taxes, ranges from a low of 10 cents per dollar of revenue raised for wine to over \$1.30 for spirits. Gabbitas and Eldridge (1998) provide a summary of estimates for several State taxes — for example, payroll tax (3–12 cents per dollar of revenue raised), petrol (40 cents) and tobacco (34 cents).

Gabbitas and Eldridge (1998) and others, including the Industry Commission (IC 1994) conclude that currently the States and Territories have tax bases that are reliant upon relatively inefficient taxes (eg payroll tax, stamp duties and taxes on financial transactions). Some taxes are also highly regressive (eg tobacco, alcohol and gambling) As taxi industry compensation funded from general revenues (as opposed to beneficiary pays models) would, by definition, come from State and Territory budgets, the deadweight cost of taxation is likely to be high.

### *Targeting and ceiling rates*

The cost of raising the revenue to fund compensation is not the only reason why governments might consider capping payments below the current market value of licence plates. Other relevant factors are:

- To the extent that:
  - plate costs reflect more than their value in pure investment terms (eg the security value of ‘buying a job’); and
  - there is a goodwill component in the value of licence plates (which the Commission doubts — see box 4.1);

then, compensation based on current market values — which reflect these influences — would exceed the losses experienced by plate holders. Thus, any compensation package should be discounted by any goodwill and security value in the plate.

- If compensation is to be paid in tandem with other forms of adjustment assistance — such as phasing — then the net present value of that phasing should be discounted from any compensation package.

Other factors which *could* have a bearing on the level (and distribution) of compensation relate to:

- the degree of ‘speculation’ embodied in the market value of plates;
- the different impacts of reform upon new entrants to the industry and LTIs; and
- the capacity of individual plate holders to absorb losses.

These are considered below.

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### *Speculation*

The market value of plates reflects plate holders' 'speculative' assessments — based on past trends — about the net present value of expected increases in *future* earnings from a constrained regulatory environment. In this context, it may be considered that compensation based on market values would mean that those paying for compensation (ie taxi users or taxpayers) would have to bear the burden for future expected 'rents' that may, or may not, have arisen — akin to paying a winning bet before the race is run.

If this argument is regarded as having merit, compensation could be capped at the net present value of the stream of income given by the current lease rate.

### *Long-term incumbents and new entrants*

Full compensation would provide the realisation of a windfall gain for the many LTIs — in particular, those who have benefited from the receipt of freely allocated licence plates. Consequently, some have argued that compensation should be restricted to recent entrants who have not had sufficient time to amortise the cost of the licence. For example, the Northern Territory Government previously submitted to the Industry Commission (IC 1994, p. 403):

... compensation should be restricted to those licensees who have recently entered the industry... This will avoid a windfall gain to those plate holders who have been in the industry for some time and have covered the cost of their plate many times over.

If it were considered to be 'fairer' to skew compensation in favour of more recent entrants, one approach would be to base the amount of compensation on the purchase price of licence plates indexed to the consumer price index (CPI). This would mean that recent plate holders would be compensated for the loss of the entire value of their purchase (ie the current market value). On the other hand, LTIs, having been compensated for their purchase price only, would face the loss of a *potential* capital gain (ie the current market value less the indexed purchase price). Those who received a freely allocated licence would not be compensated.

The Industry Commission did not favour such an approach because it considered that it would make any compensation scheme more complicated. It also stated that, while it would be possible to devise compensation schemes that might be seen as 'fairer', all plate holders suffer the same loss regardless of when they obtained their plate. It could also be argued that some LTIs may have structured their ongoing consumption and investment decisions on the understanding that the inherent value of their taxi plates provided a form of superannuation. (Indeed, some 'investors' may be people who have invested their severance pay 'nest egg' in a taxi plate.)



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If skewing compensation payments to new entrants is considered to be ‘unfair’, the available compensation fund could be distributed in equal shares across all licence plate holders.

*Capacity to absorb losses*

Some government social welfare payments (eg the age pension) are subject to an income and/or asset test to demonstrate the need for government support. A form of this approach could be applied to any compensation provided to licence plate holders. This would tend to direct compensation payments to individuals with relatively few assets and/or income sources rather than to ‘professional investors’.

Whatever the form of compensation (if adopted), the clear winners would be LTIs who sold their plates prior to deregulation (even recognising some adjustment for capital gains tax paid on the sale of post-1985 assets).

## **The phasing/compensation nexus**

As noted earlier, in practice, the distinction between adjustment assistance and compensation is often blurred. Indeed, compensation and adjustment assistance are not mutually exclusive. Each can be used to progress to a desired end-point, but they can differ in terms of timing and the incidence of costs and benefits (box 4.2).

### **Box 4.2 Compensation and phasing**

**Beneficiary pays compensation:** Where entry restrictions are removed and the government provides compensation up-front funded by a levy on taxi users or higher licence fees, taxi users derive some immediate gains such as reduced queuing and greater choice. However, as the measures used to fund compensation increase taxi operating costs or fares, the full extent of price benefits, and hence increased consumption of a lower cost service, will not be realised until the compensation has been recouped and taxi fares fall.

**Taxpayer funded compensation:** Where entry restrictions are completely removed and the government pays compensation up-front, taxi users receive full and immediate price, quality and consumption benefits. This is because, in this instance, the income transfers from taxi users to licence holders are paid up-front by all taxpayers — including non-users of taxi services — but not recouped from taxi users.

**Phasing without compensation:** The time frame of any phased deregulation of entry restrictions bears directly on the timing and magnitude of consumer gains and licence holder losses. For taxi users, the price, quality and consumption benefits accrue over time and are fully achieved only when the entry restrictions are completely liberalised. The transfers from taxi users to licence holders continue over this period. However, unless this phasing period is of an inordinately long duration, the quantum of transfers will be less than that which would arise under compensated approaches.

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Relative to a compensation approach, phasing defers the achievement of efficiency gains, but reduces the size of transfers from taxi users to licence holders. The two compensation approaches also differ in terms of who pays for the transfers to licence plate holders. Thus, while taxpayer funded compensation models can provide immediate price and efficiency benefits for taxi users, this is at the expense of those taxpayers who do not use taxi services (even with lower fares).

Policymakers may opt for a combination of adjustment assistance (such as phasing) and partial compensation. In these circumstances, the longer the phasing period, the lower should be the compensation.

The range of options for implementing the easing, or removal, of entry restrictions in the taxi industry can be classified into four broad categories:

- (i) *Deregulation without compensation:* This is essentially the New Zealand model involving rapid removal of entry restrictions without compensation.
- (ii) *Deregulation with ‘full’ or partial compensation:* This approach would include the model adopted by the Northern Territory which involved the removal of entry barriers accompanied by compensation based on the market value of licences.
- (iii) *Phased implementation without compensation:* This option includes the model in IPART’s interim report which involves a progressive freeing up of entry barriers with a further review in five years’ time.
- (iv) *Phased implementation with partial compensation:* This option could include, for example, option (iii) with some compensation for plate owners.

Under options (ii) and (iv), possible variations derive from the method of disbursement of compensation (eg equally or skewed to new comers) and the method of funding the package (eg a levy on fares, increased taxi and hire-car licences fees, or taxpayers in general).

## 4.4 Concluding comments

The provision of compensation is a complex but important matter for governments to resolve. Whether compensation should be paid — and if it is, how much and in what form — depends on how governments view a range of factors including:

- efficiency and equity;
- perceptions of fairness; and

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- broader, often pragmatic, considerations.

To assist decision makers, box 4.3 contains a (non-exhaustive) set of issues which could be taken into consideration in assessing the merits or otherwise for compensation to accompany taxi industry reform. More overtly ‘political’ concerns are not included.

If compensation is to be provided, the Commission considers that the following considerations should be borne in mind.

- There is an inverse relationship between the length of phasing and the magnitude of any compensation package. Indeed, full compensation implies no need for phasing.
- Compensation should not exceed the current market value of taxi plates discounted by any goodwill or value associated with acquiring a job incorporated in the value of the plate;
- Funding compensation by increasing state or territory taxes is likely to result in significant costs (deadweight cost of taxation);
- Compensation payments could be allocated amongst plate holders in equal shares, skewed toward those who have purchased plates more recently or ‘means tested’ to target payments to those most disadvantaged by deregulation.

Governments could also consider the merit of capping compensation payments based on:

- the net present value of the stream of income given by the current lease rate; or
- the purchase price of plates (indexed to the consumer price index).

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### Box 4.3 **Factors relevant to the consideration of compensation**

#### ***Efficiency considerations***

- Will compensation facilitate or hinder adjustment?
- What are the efficiency benefits of providing compensation?
- What are the efficiency costs of compensation funded from the budget and/or users?
- Can compensation be delivered without creating unintended distortions?
- Can licence holders be clearly identified and compensation quarantined?
- Can compensation be made transparent with low administrative and compliance costs?

#### ***Equity/fairness considerations***

- What is the nature of the taxi licence property right (eg Constitutional, quasi, implied)?
- Was any contract or implicit guarantee given that the degree of restrictiveness (and thus 'economic rents') from taxi regulation would be maintained?
- Have significant changes in the nature of licence plates from government action occurred in the past or would deregulation mean that plate holders are subject to completely unanticipated reform?
- If licence plate holders are to be compensated for wealth-reducing reforms, have they also been taxed for policy changes which have enhanced their profits (eg periods in which no new licences have been allocated)?
- Have governments appropriated any of the 'economic rent' through plate auctions?
- Would (uncompensated) reform result in adverse distributional consequences — for instance, what is the wealth profile of plate holders and taxi users?
- Should actual capital losses (new entrants) and losses of potential capital gains (those holding freely allocated licence plates) be compensated in the same way?
- Which groups will bear the burden of the costs of a compensation package?
- What will be the opportunity cost of budget funds expended on compensation and what are the likely distributional consequences?
- Are the interests of plate holders and taxi users and/or taxpayers well represented or does one group have a more effective 'voice'?

#### ***Broader considerations***

- Is taxi reform unlikely to proceed without compensation?
- Is compensation likely to encourage calls for similar treatment from other activities subject to reform with attendant deadweight costs (eg diversion of effort into rent-seeking and lobbying)?
- Will the payment of compensation make the achievement of future reforms difficult?
- What are the relative efficiency and equity outcomes of various phasing-compensation packages — ranging from full compensation with no phasing, to no compensation with a very long phasing period?



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