



## ESC Taxi Fare Review 2016 Victorian Taxi Association Submission

5 February 2016

The Victorian Taxi Association (VTA) wishes to state from the outset that while it recognises it is no fault of the Essential Services Commission (ESC), the timing of this review is inappropriate given the prevailing uncertainty about the future extent of regulation of the commercial passenger vehicle (CPV) industry in Victoria.

The State Government is currently considering complex public policy challenges thrown up by the emergence of illegal ridesharing services in Victoria which are illegitimately competing with regulated taxi services in Victoria and have important implications for the future of the CPV market.

As a result, the VTA does not believe the ESC is in a position to reach any meaningful conclusion from the current fare review process until these systemic policy questions are addressed by Government. The future of fare regulation and fare setting is central to the ongoing deliberations of Government and need to be a feature of any considerations.

It is the view of the VTA that the current ESC process should be delayed until Government determines the future of CPV regulation. An interim measure, as an outcome of this current process required under law, could be to process an increase, to the value of CPI, since the last fare adjustment (May 2014) until a more detailed analysis is conducted with greater certainty following a decision from Government.

### **The future of fare regulation**

The VTA's view more broadly is that fare setting in taxis should be deregulated.

Given the demonstrated inability to compel compliance with existing fare regulation by new market entrants, and the unlikely ability to do so in the future, it is only reasonable that all CPV providers be given the freedom to compete on fair terms.

The VTA are yet to hear a compelling argument as to why price surging within the current context is not blatant price gouging. Increasingly, public commentary points to the fallacy of the idea that surges, up to a factor of 10 times, are motivated by a desire to increase supply at time of high demand. Only competition will be effective in restraining this kind of gouging and this will ultimately soften the market.

A genuinely competitive market with dynamic pricing across all service providers would result in competition for both drivers and customers during quiet and busy periods with the customer the

beneficiary. Naturally, there should be an expectation on all providers that there is transparency for customers as to the price they will be charged for any given journey. The mechanism by which this is achieved should be determined by providers.

### **What has changed?**

In preparing this submission the VTA recognises that the commercial passenger vehicle industry has changed significantly since the ESC did its last fare review in 2013-2014.

These changes have been well documented in various public forums and in the media. Much of the reporting and commentary has missed the most systemic shift that has occurred: genuine external competition has developed in the CPV market reducing the need for Government intervention. Much of the existing regulation, including fare regulation, is premised on the notion that there was a lack of external competition to taxi services. As a result of this assumption, there was the belief that (when it came to the setting of prices) there was a market failure, due to the lack of competition, which could lead to passengers paying more than they should at certain times of day and too little at other times of day, which would make taxi businesses unviable.

Whether this was or was not the case is now largely irrelevant. The industry is facing significant external competition (albeit at the time of writing this submission from an illegal service) which has addressed the perceived market failure because external competition has emerged. Of importance here is the fact that the illegal service does not adhere to the regulated prices set by the ESC and charges what they claim to be a 'dynamic price' reflecting demand. In this context the VTA believe it is no longer necessary or appropriate to regulate taxi fares, or any price charged by Victorian commercial passenger vehicle operators.

One of the arguments from regulatory authorities responsible for setting taxi fares was that increasing fares would harm the industry and the consumer because it would make it less affordable and as a result dampen demand for the service.

This was a justifiable argument while the Government controlled the number of taxi licences on the road, because the restricted supply could potentially lead to higher prices. With the removal of these barriers to entry via licensing, legislated by the previous Victorian Government, the market is now free to find its own equilibrium. If the industry were enabled to set its own price, and set it too high, this would be detrimental to its own financial sustainability. Most importantly, it would send a signal to the market and potential new entrants that there were business opportunities available to competitors. This process would naturally soften the price for the consumer because the new market entrants would absorb the additional demand, reducing overall returns to the commercial passenger vehicle services, resulting in the lowering of prices to attract new, and retain existing customers.

In this context, the regulation of prices that taxis can charge, combined with other factors such as regulated driver/operator splits, is placing the industry in a perilous financial and commercial position. While competitors, due to their lack of compliance with the law, are able to price dynamically, the legal taxi industry is left to work within a largely politically-motivated pricing structure that bears little genuine resemblance to movements in demand. As a result, Government is left with a stark choice; either find a way to ensure all competitors in the commercial passenger vehicle market comply with regulated pricing or allow all to set their own prices with only the lightest of regulatory intervention (perhaps, for example, establishing who can set the price). The VTA supports the latter proposal.

From the VTA's perspective, the most concerning feature of the existing market is that demand for regulated CPV services does not appear to be declining, yet the businesses that constitute it are struggling to remain viable. This is an unhealthy situation. The reason many businesses are struggling is not because of the lack of demand for their services but the manner in which regulation, particularly fare regulation and the regulated distribution of income, restricts their ability to respond to demand.

The VTA will address three key reasons it believes that fare regulation is no longer necessary, enforceable or desirable. They are:

- The lack of concern from consumers;
- Failures of regulatory enforcement across the market; and
- Systemic changes in the industry that appear to have addressed the historical perceived market failure.

### **1. The consumers' perspective**

The notion that there is a market failure requiring regulatory intervention in the setting of prices for CPV services has long been unchallenged. As previously outlined, recent changes to the market mean that the assumption on which prices for a CPV service should be regulated need to be reconsidered.

What is known is that there is little consistent economic theory regarding this subject and political objectives often overshadow the economic and commercial considerations. One of the externalities of this fact has been an overly emotive debate about the appropriate price point for regulated taxi services. Naturally, the industry seeks fare increases, while consumers and peripheral interests call for the reduction of fares. It is interesting to note, that there is a significant divergence in prices between different jurisdictions despite similar cost structures and demand patterns.

Another important factor to consider is while consumers innately do not like to pay more, the demand for taxi services is elastic. Recently, with the emergence of Uber and its dynamic pricing model, consumer behaviour has emerged which demonstrates relative comfort with this approach. They appear to be willing to pay less (naturally) during low demand periods but also willing to pay increased prices during periods of high demand. Similar anecdotal findings have become apparent in regional Victoria where fare setting is already deregulated. The VTA has seen few complaints about increases to pricing across the State.

One area where consumers have voiced significant concern is around Uber's 'price surging' beyond what the market considers reasonable. Extreme examples include exponential increases in prices during the 2014 Sydney Siege, the Sydney storms of 2015 and during the 2015/16 Christmas and New Year period. In these isolated examples Uber increased their price by up to 10 times. Regulators have been either reluctant or unable to hold the company responsible for their actions.

Arguably, one reason Uber are able to surge to the level they do is because there are no competitors similarly free to price dynamically and thus moderate their surges. For example, if taxi companies were permitted to price in a similar fashion, it is reasonable to assume that in the cases of such extreme surges, taxi companies would respond by undercutting the headline price thus leading to a softening of the market.

## **2. The failure of regulatory enforcement**

It has become abundantly clear that since the ESC did their last fare review, regulators have found it increasingly difficult to enforce regulations across the CPV industry, creating significant inequity.

Victoria's laws, regulation and accompanying penalty regime were designed to deal with individuals who did the wrong thing, not large multi-national corporations. This is why regulators have found it so challenging to deal with the emergence of entities that wantonly break the law. Victorian regulators simply do not have the power or resources to stop them.

As a result, Government is left with a choice that extends to the regulated setting of fares for CPVs: continue to enforce regulated fares, and overhaul the laws, regulations and penalty regime to ensure compliance by all in the market; or move to a new market based solution which would see fares set by participants in the industry.

The VTA's preference is for the latter given the concerning lack of ability to effectively enforce the existing laws as well as the significant shifts in the structure of the market over the last two years. The attitude of new entrants towards following the law also makes it hard to see how any other scenario is practicable. In the absence of effective regulation and its enforcement, the taxi industry must be allowed to compete in all areas of the market, including on price, with new service models.

Ridesharing providers would like Governments to believe ridesharing is inherently different to taxi services – this is a myth which is perpetuated to justify maintaining two-tiered regulation preventing taxis from actively competing with ridesharing providers.

Recent reforms announced in NSW reinforce this narrative by claiming taxi licence value can be protected and markets carved out by preventing ridesharing services access to rank and hail markets.

Not only is this approach representative of an outdated perspective on the operation of CPVs but it is unsustainable and unenforceable. It is inconceivable that technology and consumer behaviour will not change in response to the development of the market, therefore fundamentally shifting the definition of rank and hail work. Such an outcome which has prevailed in NSW, holds taxis back from truly competing with new market entrants and will lead to the need for further reform in the near to medium term.

Nothing here is suggesting that there is not a role for regulators in the commercial passenger vehicle space. However, it is important that the regulations reflects changes in the market and seek to address market failures and not stand in the way of competition.

## **3. Transformative change**

Positive theories of government regulation articulates four key motivations for government intervention in the market through regulation:

1. Seeking to overcome information asymmetries in order to align the operator's interest with the government's interest
2. Protection of customers where competition is non-existent or ineffective
3. Protection of operators from rivals
4. Protection of operators from government opportunism.

These all represent market failures which have been observable in the taxi industry in Victoria. These failures existed in the absence of a functioning market and thus demanded significant Government intervention.

It is hard to deny that operators of CPV services in Victoria now do so in a competitive market in which consumers have more choice. It is in this context that Government must consider the necessity and desirability of prescriptive regulation. There will always be a role for Government to provide basic consumer protections around the suitability of drivers and vehicles operating commercially, but it is questionable which market failures persist requiring Government intervention beyond this.

Another factor that must be considered in this discussion is the ability of modern technology to better align demand and supply. For many years regulators have tried to create various price points for a taxi based on demand patterns. The issue with this approach is that it is necessarily broad and accounts only for a generalised and rudimentary demand pattern, and cannot account for localised or specific demand patterns. Different areas, different demographics and different service types do not necessarily have the same demand patterns. New technology means that businesses are better equipped to accurately measure demand in real time and price accordingly.

This approach would deliver significant advantage to consumers as it would align supply to demand, leading to a proliferation and differentiation of service types and make the options available to customers at any point in time more transparent.

In discussions with the ESC, the notion of the need for a transition arrangement to move the existing industry to the type of model outlined above has been raised. The VTA do not consider this as necessary. However, if there was a strong view that a transition period was required, the ESC could set a fare structure, as they currently do, and allow Network Service Providers who wish to use it to do so, while allowing others to set their own fares above, below or in a different way entirely, through a price notification system. This is similar to the approach taken in regional areas after the Taxi Industry Inquiry recommendation to deregulate fare setting was accepted by the Government of the day.

## **Conclusion**

This paper aims to make clear that the Victorian taxi industry is ready to embrace competition in regards to how fares are set. The VTA is urging bold systemic reform to the industry and significant regulatory reform, including the deregulation of fare setting for commercial passenger vehicle services. The VTA wants to see a dynamic and diverse industry in which companies must compete for the customer. Some businesses will fail, some new services will emerge and the industry will change in ways we cannot anticipate – with the customer the beneficiary. This vision can only be realised if everyone is following the same rules. The price a commercial passenger vehicle service can charge and how this is determined is a key issue to be addressed.

The VTA understands that the ESC have a specific task regarding the setting of taxi fares and do not have the ultimate power to enable the type of price setting outlined in this submission. However, it is clear the ESC have a role in advising Government about the best way forward.

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