Compensation in the Australian Taxi Industry

PROFESSOR RICHARD HOLDEN

JULY 2016

THIS REPORT WAS COMMISSIONED BY UBER

CONTENTS

PAGE 1 **ABOUT THE AUTHOR**

PAGE 2 **EXECUTIVE SUMMARY**

PAGE 3 **RATIONALE FOR REGULATION**

Different participants have different responsibilities
Different models are regulated in different ways

PAGE 6 **THE ECONOMICS OF COMPENSATING LICENCE HOLDERS**

Ex ante and ex post gains and losses

The policy expectations lottery
Did perpetual licence holders already receive an economically fair return?
Hardship compensation

Incentive effects of compensation
Legal basis for compensation
Practicalities of compensation
Appropriate uses of levies
Costs of delaying reform

PAGE 14 **CONCLUSION**

About the author

RICHARD HOLDEN IS PROFESSOR OF ECONOMICS AT UNSW AUSTRALIA BUSINESS SCHOOL AND AN AUSTRALIAN RESEARCH COUNCIL FUTURE FELLOW FROM 2013-2017.

Prior to that he was on the faculty at the University of Chicago and the Massachusetts Institute of Technology. He received a PhD from Harvard University in 2006, where he was a Frank Knox Scholar.

His research focuses on contract theory, organisational economics, law and economics, and political economy. He has written on topics including: political districting, the boundary of the firm, incentives in organisations, mechanism design, and voting rules.

Professor Holden has published in top general interest journals such as the American Economic Review and the Quarterly Journal of Economics.

He is currently editor of the Journal of Law and Economics, and is the founding director of the Herbert Smith Freehills Initiative on Law & Economics at UNSW.

He has been a Visiting Professor of Economics at the MIT Department of Economics and the MIT Sloan School of Management, and Visiting Professor of Law at the University of Chicago Law School. In Fall 2016 he will be a Visiting Professor of Economics at the Harvard Economics Department

His research has been featured in press articles in such outlets as: The New York Times, The Financial Times, the New Republic, and the Daily Kos.

Professor Holden appears regularly on PVO News Day on Sky News and writes for The Australian Financial Review. He also writes a weekly column analysing global economic data called Vital Signs for The Conversation.

Executive summary

The economic case for compensating existing licence holders is not strong.

Licence holders who have held a perpetual licence for an extended period of time have likely already received economic returns that have implicitly compensated them for a change in the regulatory environment.

It is unlikely that the future value of licences will be zero; rather, they will retain a positive value.

If other Australian jurisdictions adopt the regulatory models similar to those of NSW and the ACT, taxi licences will continue to provide an ongoing source of income for the licensee from the protected rank and hail market.

There is a lack of publicly accessible evidence to support the argument that compensation should be paid. Governments should release modelling that justifies their decisions to compensate.

Consumers should know who is being compensated. There is a lack of publicly accessible data on licence ownership. Consumers should be made aware if they are compensating investors, such as corporations and trusts.

The data that is publicly available would suggest that since the introduction of ridesharing the growth of the taxi market has remained steady.

There may be a case for some form of payment based on hardship grounds, but such hardship relief should take account of the financial wealth of the licence holder.

Any hardship suffered by licence holders is a consequence of inaction by successive governments to regulate the trade of taxi licences. It is appropriate that any hardship relief is paid by the government rather than consumers or other market participants.

A levy on consumers or emerging sectors will delay the benefits of reform.

Rationale for regulation

Different jurisdictions across Australia regulate point to point transport for different reasons. Safety is the animating principle in most states and territories: ensuring competent service delivery, compliance with basic safety standards, and the accountability of industry participants. Transport reliability is an objective too, as is affordability. Some jurisdictions bundle these objectives into a broad statement of customer interest: regulation that is "responsive to customer needs", "responsive to community needs" or "focused on serving the customer". In the words of a former New South Wales Transport Minister, and current Treasurer, Gladys Berejiklian "at the end of the day it is about our customers".

Economic efficiency features prominently as a regulatory objective, as does the "reduction or elimination" of regulatory imposts where possible. Other principles appear less frequently. Encouraging innovation features as an objective in the principal Act of only one state. Other states refer to improving universal accessibility for disadvantaged groups, social justice, and environmental harm minimisation.

Transport legislation in some jurisdictions explicitly refers to market restrictions – controlled licensing – as an objective of regulation.

The Queensland transport Act justifies market restrictions only where transport access, innovation, social justice and service levels would be greater than otherwise available. Likewise, Western Australia envisages market restrictions only where "such measures contribute to the provision of reliable, efficient and economic transport services". South Australia offers no such justification.

Other states have questioned the efficacy of market restrictions. In a series of reforms commencing in 2009, New South Wales refused to release further indefinite 'ordinary' licences. Justifying the release of new annually renewable licences, the Government cited the scarcity of taxis and upward pressure on fares:

There are not many things that members of this House agree upon, but this has to be one of them… This is a central plank in the Government's reform proposal as it takes the industry in a new direction: one in which the primary focus is on building a business based on delivering services to passengers, rather than on the underlying capital value of the licence. The message is that if you want to take up a new licence you must run a taxi service to make a return.

The new annually renewable licences are transferable but not assignable under a lease. The Victorian Government also ceased to issue perpetual licences in the wake of the 2012 Taxi Industry Inquiry, citing the "dense, prescriptive" state of contemporary legislation, as did the Australian Capital Territory following a set of reforms in 2015. The new Victorian annually renewable licences are "as of right" and may be assigned but not transferred.

Different participants have different responsibilities

These regulatory schemes have given rise to a complex network of industry participants with varying levels of accountability and responsibility. Across Australia, the taxi industry is characterised by a division of ownership, management and service delivery among up to five or more different stakeholders.

Licensees

hold a licence issued by the government to operate a taxi or hire car. Licensees can operate the service themselves ("owner-operators") or lease their licence to an existing operator in exchange for a lease fee.

Operators

are responsible for the day-to-day management of a taxi or hire car service. Operator responsibilities include engaging drivers and maintaining vehicles. Regulators generally treat the operator as a business owner: for instance, operators may be required to comply with standards relating to financial management and accounting.

Networks

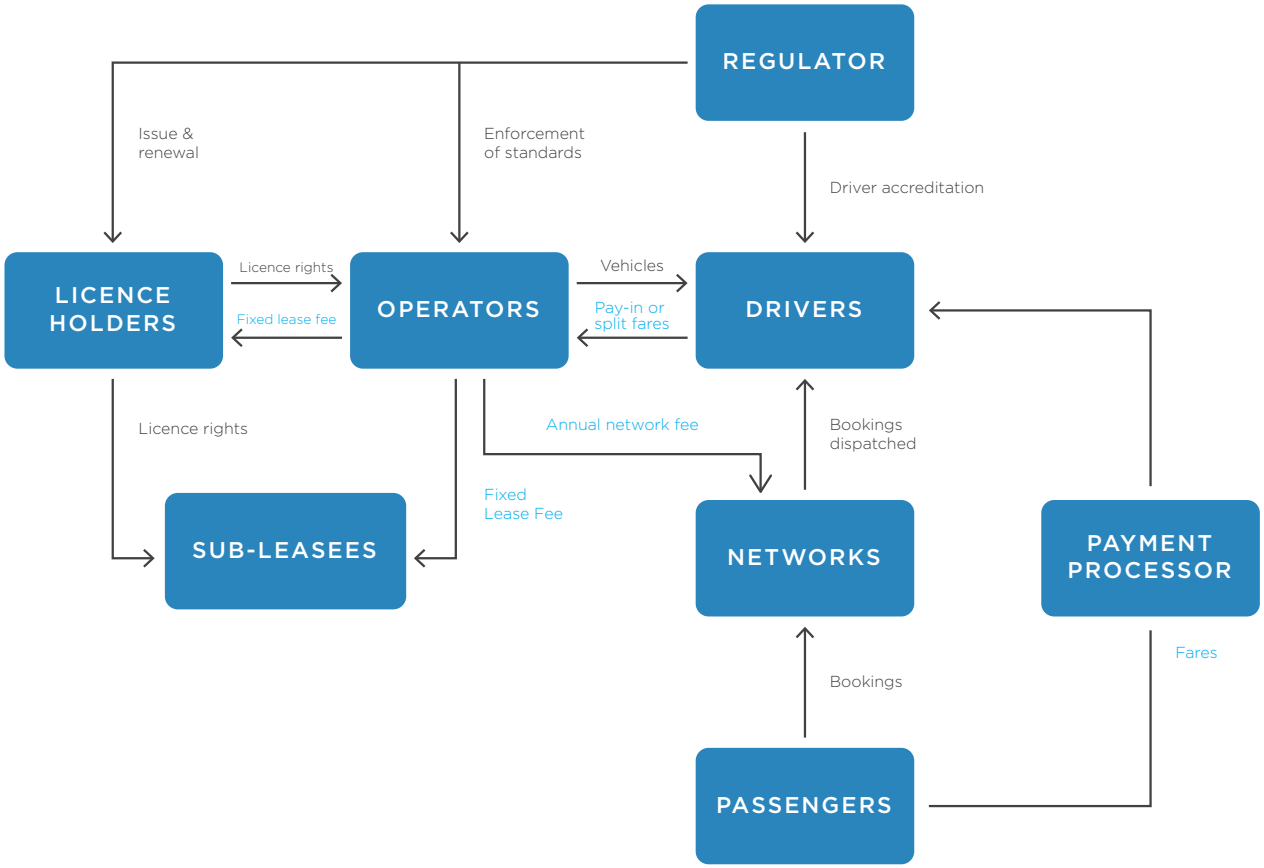
receive and dispatch bookings in exchange for an annual network fee paid by the operator. In many jurisdictions, transport regulations mandate that taxi operators affiliate with a network.

Payment processors

facilitate credit card payments in exchange for a surcharge imposed on passengers. A number of states have capped the maximum permissible surcharge in response to widespread consumer dissatisfaction.

Drivers

are responsible for service delivery. Under the most common bailment model, operators lease a vehicle to the driver in exchange for a fee. In New South Wales, Victoria, Queensland and South Australia, the bailment fee may consist of a set "pay in" or a 50 to 55 per cent split of farebox revenue.



Different models are regulated in different ways

These participants share some regulatory requirements. For instance, drivers, operators and networks are generally required to undergo 'fit and proper person' accreditation administered by the transport regulator.

These requirements may apply across all regulated transport models, including taxis, hire cars and regular passenger services.

In other respects, however, different transport models are regulated in different ways. Taxis are legally distinguished from other transport models by their exclusive capacity to "ply for hire" in public streets and to collect passengers from dedicated taxi ranks. This unbooked "rank and hail" market constitutes 68 per cent of taxi work nationally, and up to 80 per cent in states such as New South Wales.[1]

Rank and hail work carries particular commercial and safety risks compared to the pre-booked work characteristic of hire cars, or the pre-requested and "ready-to-ride" work characteristic of ridesharing. Neither the passenger nor the driver knows the identity of the other party prior to entering the taxi. No third party can attest to the credentials of the hailed vehicle. Taxis regularly carry cash.

And as a business based on spontaneous and unpredictable rank and hail work, it is difficult to match supply and demand, and impossible to build a client base or generate business goodwill.

These risks traditionally justified certain qualitative regulations for taxis distinct from the regulations applicable to other models. Taxis are required to carry cameras to mitigate the risk of criminal behaviour by anonymous passengers. They must be marked in particular ways to ensure that passengers can identify accredited vehicles.

Fares are regulated since a consumer cannot reasonably determine or 'shop' for competitive fares in the course of hailing a taxi. And before the emergence of GPS technology, urban navigation training (the 'knowledge' test) was a common regulatory requirement since hailed drivers could not pre-plan the route.

Quantitative regulations are different too. Taxi licences are more expensive, and generally more tightly controlled, than hire car licences. These supply controls and barriers to entry addressed fears that a glut of taxis competing for finite rank and hail work would impermissibly erode driver and operator earnings.

[1] *Australian Taxi Industry Association (2014), state and territory statistics.*

The economics of compensating licence holders

From an economic perspective, a licence is a financial asset. When there are changes in the regulatory environment that affect the value of this asset, the question of compensation naturally arises. This section considers the economic arguments for and against owners of this financial asset receiving compensation from a change in the taxi licensing regime.

Ex ante and ex post gains and losses

THE POLICY EXPECTATIONS LOTTERY

A useful way to think about the asset that taxi licence holders purchased was that it was a kind of lottery ticket. In one state of the world, regulations barring entry would continue and holders would enjoy super-normal returns; in an alternative state of the world such regulations would end, entry would be allowed, and returns would be lower.

In markets with these kinds of risks, from regulatory or other sources, asset prices typically adjust to ensure that investors earn an appropriate return.

Empirical evidence for the proposition that the market adjusts asset prices for risk can be found in the municipal bond market in the United States. Municipal bonds have historically enjoyed a privileged tax status, but there is always the risk that this tax status could change.

Massachusetts Institute of Technology economist James Poterba studied the US municipal bond market and found that one-year municipal bonds earned materially lower returns than one-year treasury bonds between 1955 and 1983.[2] By contrast, the gap between twenty-year municipal bonds and twenty-year treasury bonds was much smaller. This reflects the fact that a change in tax-exempt status was much more likely to occur over a twenty-year period than a one-year period. The market adjusted for risk.

As Poterba puts it: "[the paper] provides clear evidence that the yield spread between long-term taxable and tax-exempt bonds responds to changes in expected individual tax rates."

In short, assets that face a larger probability of a negative policy change are priced lower than otherwise equivalent assets that face a smaller probability of such a policy change. This, in turn, implies a higher return.

If asset markets adjust prices for policy risk, then ex post compensation is both unnecessary and counterproductive. Such compensation would be analogous to compensating losing lottery ticket holders for not winning the lottery. Not only does their "compensation" come ex ante, through the price of the ticket, such ex post compensation provides perverse incentives for excess purchases of lottery tickets.

[2] *James M. Poterba (1989), "Tax Reform and the Market For Tax-Exempt Debt," NBER Working Paper 2900.*

DID PERPETUAL LICENCE HOLDERS ALREADY RECEIVE AN ECONOMICALLY FAIR RETURN?

Given the barriers to entry that licences have historically created, it is natural to ask whether existing licence holders have already received an economically fair return for their investment. Clearly, if this is the case, it limits the rationale for compensation—even on equity grounds.

To address this issue it is useful to calculate the Internal Rate of Return ("IRR") from an investment in a perpetual licence, beginning at different points in time. To do this we assembled data on the price of perpetual licences in New South Wales and Victoria going back to 1985.[3]

We assume that the payments to licence holders reflects a yield of 6% per annum in every year.[4] Another important assumption, when consider returns beyond the present time, is forecast price appreciation of licences, going forward.

Licences still will still have value going forward for a number of reasons. One is that taxis and ridesharing services are not perfect substitutes for each other. Some passengers prefer to use a taxi rather than a ridesharing service; some passengers prefer the immediate convenience of hailing an available taxi in the street; and some customers do not have the requisite technology (e.g. a smartphone) to use ridesharing as currently constituted. Another reason is that increased competition provides taxis increased incentives to improve their product offering and grow market share. New and improved mobile phone booking apps developed after Uber's entry mirror some of the functionality of the Uber app (e.g. maps), illustrating how competition improves the whole market.

A recent report[5] by the Independent Pricing and Regulatory Tribunal ("IPART") points to some of the positive impacts that the advent of ridesharing services have had on the taxi industry, in part through the expansion of the market. Based on survey evidence they find, among other things, that:

The prevalence of taxi use has grown since 2012. In 2012, 55 percent of Sydney adults surveyed had used a taxi in previous last 6 months. That number grew to 58 percent in 2014, and to 61 percent in February 2016.

The broader point to point market has also grown: hire car usage was up from 21 per cent to 24 percent in the prior six months, and ridesharing service usage grew from 19 per cent to 22 per cent.

This growth appears to stem from new customers of hire car and ridesharing services over the 6 months to February 2016, rather than these alternative point-to-point services replacing taxi usage.

Users of ridesharing services continue to be more likely to have used a taxi in the last six months (93 percent), when compared to non-users of ridesharing services (52 percent).

17 per cent of Sydney adults surveyed had caught taxis more in the last 12 months compared to the prior 12 months.

[3] Roads and Maritime Services, http://www.rms.nsw.gov.au/about/corporate-publications/statistics/public-passenger-vehicles/taxi-transfers-average-prices.html (accessed April 30, 2016) and prior version of this webpage.

[4] See Alan Fels (2012), Final Report: Customers First: Service, Safety, Choice. Available at: http://taxi.vic.gov.au/__data/assets/pdf_file/0019/20791/Taxi-Industry-Inquiry-Final-Report.PDF (accessed April 30, 2016).

[5] IPART (2016), http://www.ipart.nsw.gov.au/Home/Industries/Transport/Reviews/Taxi/2015_Survey_of_Taxi_Use/04_Feb_2 016_-_Media_Release/Release_of_Taxi_use_survey_results_-_4_February_2016

It seems likely, therefore, that licences will continue to be a valuable asset, even if their capital value fluctuates in response to regulatory uncertainty.

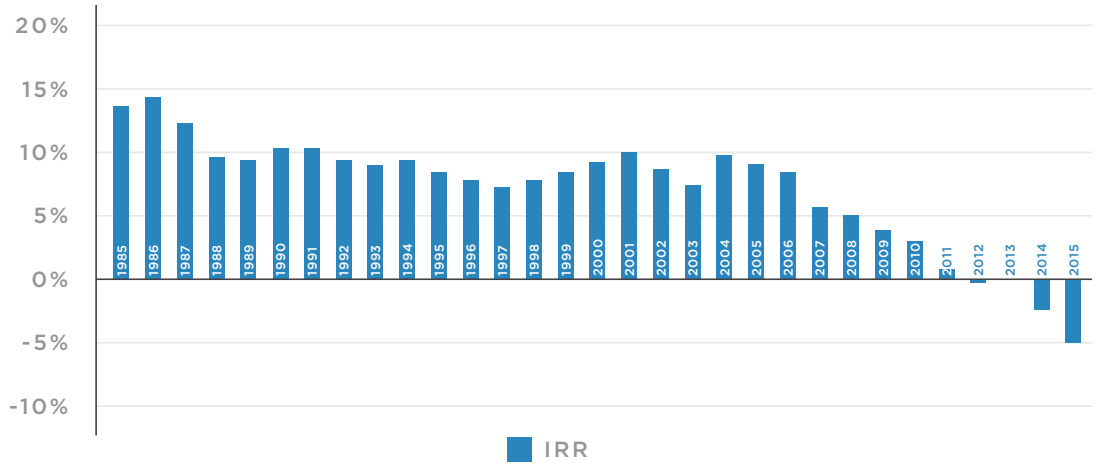
It is not possible to accurately forecast the future value of licences, but for the purposes of this analysis we assume a -5.0% per annum rate—i.e. an annual, compounded, decline in licence value/price of 5%.

With these assumptions, together with the historical licence-price data, we are able to compute the IRR on licence purchases in New South Wales and Victoria at any entry and exit year from 1985 to 2018.

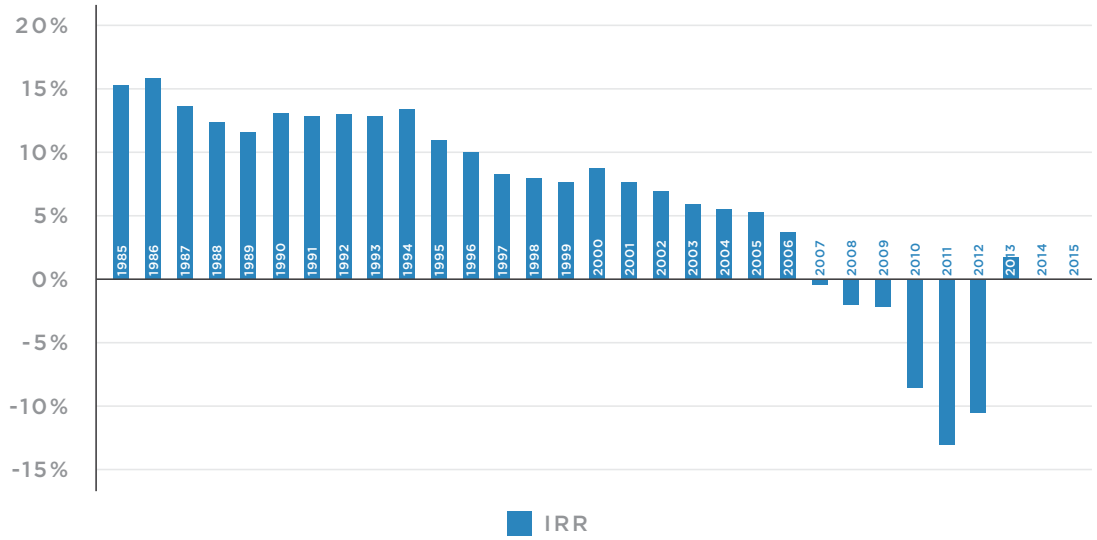
The following chart presents the IRR for licence purchases in New South Wales for different starting years, assuming a 2016 exit.

It is clear from the top chart that licence holders who purchased prior to 2008 received an IRR of 5.0% or greater. Indeed, purchasers in earlier years earned substantially higher returns, with IRRs above 10% for several years, and as high as 14.2% for 1986 purchasers. The same analysis for Victoria is contained in the bottom chart.

NEW SOUTH WALES IRR FOR 2016 EXIT



VICTORIA IRR FOR 2016 EXIT



Although the numbers differ to some degree from those for New South Wales, it is also clear from the Victorian chart that purchasers who bought prior to 2005 earned an IRR of above 5% (as compared to 2008 for New South Wales). For Victoria, there are more purchase years where the return was greater than 10% (including every year from 1985 to 1996). It is also the case that the maximal returns were higher than in New South Wales, with the returns for purchasers in 1985 and 1986 being 15.7% and 16.1%, respectively.

An obvious question is what level of return is consistent with the concept of "economically fair". To address this, consider the annual returns on the following asset classes. Australian shares, as measured by the ASX 200 Net Total Return Index, have returned 7.1% on an annualised basis from Jan 1 2000 to Jan 1 2016.[6] The New South Wales Taxi licence IRR, shown above, was 9.2% and the Victorian IRR was 8.6%. Over the same time frame, Australian 10 year government bonds have yielded an average of 4.995%.[7]

Moreover, the ASX Net Total Return Index involves re-investing dividends in shares (post withholding tax), whereas the IRR for taxi licences does not involve re-investing rental payments.

Were such payments re-invested—and hence compounded—the return on licences would be even more attractive.

The appropriate level of return on an asset depends on the riskiness of the asset, but bonds and equities are typically seen as spanning most of the spectrum of risk. The fact that taxi licences, then, outperformed both assets over the period suggests that licence holders earned an above market return.

Another important factor in assessing the benefit of holding the taxi licence asset is the diversification benefits it may bring. It is well known that holding an asset that not (perfectly) correlated with other assets held yields a diversification benefit.[8]

Computing the correlation between annual total returns on New South Wales taxi licences and the ASX 200 (a broad measure of share market performance) reveals a correlation coefficient of -0.166. For Victoria the correlation coefficient is -0.160. This suggest that, to the extent that licence owners held shares, either directly, through a mutual fund, or in a superannuation account, holding a taxi licence provided them with a diversification benefit in addition to the return on the licence itself.

Although it is not possible to quantify the magnitude of this benefit without knowing the composition of the rest of their portfolio, the benefit could be significant.

It is also important to note that licence holders who continue to hold a licence to this date have chosen to do so. Furthermore, they have done so after the advent of ridesharing services and various licensing reforms commencing as early as 2009 (NSW) and 2012 (VIC). On a revealed preference basis, therefore, they must believe that taxi licences continue to be an attractive asset.

Of course, this may factor in some expectation of future compensation. But again, this is essentially the purchase of a lottery ticket, and it is unclear that compensation should be provided to people who have chosen to take such a gamble. At a minimum, the rationale for compensating people for freely choosing to take such a gamble is very different from other potential rationales.

[6] *Investing.com, http://au.investing.com/indices/s-p-asx-200-net-total-return-historical-data (accessed June 2, 2016).*

[7] *Investing.com, http://au.investing.com/rates-bonds/australia-10-year-bond-yield-historical-data (accessed June 2, 2016).*

[8] *See Markowitz, H.M. (March 1952). "Portfolio Selection". Journal of Finance 7 (1): 77–91 for a classic reference.*

HARDSHIP PAYMENT

One potentially valid public policy consideration is to compensate individuals based not on the economic merit of their claim, but on the hardship they face.[9] For instance, people who purchase homes in risky areas that are subject to natural disasters (such as bushfires, floods, and earthquakes) are sometimes seen as sympathetic victims who deserve compensation.

Economically, of course, people who bought such "natural-disaster-prone" properties: (a) purchased those properties for a lower price than would otherwise have been the case and thus received a benefit prior to the disaster occurring; and (b) often could have purchased insurance against the disaster. As such, their economic claim to compensation is dubious.

Notwithstanding this, they often receive compensation. The political case for compensating[10] victims is beyond the scope of this report, but it does raise two important questions. The first is who should receive it; the second is who should pay it?

If the basis for sympathy of so-called "victims" is hardship and their economic circumstances then, assuming such circumstances vary across persons, compensation should not be uniform either. For instance, already wealthy potential compensatees might be seen as unsuitable for compensation. Similarly, those who had already enjoyed supra-normal returns during the time of holding their licence might not be seen as particularly sympathetic, or worthy of compensation.

There is a lack of publicly available data that permits consideration of whether a licence was purchased directly from the government, or second hand through the market. Governments have historically not released this information. Licences have been purchased on the private market and have been sold for large profits. The question needs to be asked whether it is reasonable for perceived losses to be socialised when the industry has never socialised the profits.

The second question here is, who should pay? In the case of property owners, it is typically the case that compensation is paid for by government. To the extent that government and society generally has an interest in fostering innovation that benefit consumers then one can make a compelling case for government being the appropriate payer of any perceived "hardship payment".

This case is bolstered by the fact that government determines the regulatory environment. If a rational government believes that, in any industry, the benefits of a change to the regulatory environment outweigh the costs then they will enact the change.[11] It is unclear why any particular constituency should be required to pay for compensation, rather than society as a whole through consolidated revenue of the appropriate government.

A useful analogy is structural adjustment programs in Australia. These programs are designed to compensate certain regions, industries, and individuals who are negatively affected by trade policies. In the period 2000-2012 approximately $88 billion was spent for these purposes, largely from the Commonwealth government.[12]

[9] In the context of the Australian taxi industry see a recent report by the Grattan Institute available at: http://grattan.edu.au/wp-content/uploads/2016/04/871-Peer-to-peer-pressure.pdf (accessed April 30, 2016). They conclude: "An ethical case may be made for offering partial compensation to taxi and hire-car licence owners who bought licences recently and who face financial hardship. If governments decide compensation is warranted, it could consider when the owner bought the licence (and the average price prevailing at that time), the number of licences held, and, if feasible, the owner's financial position, including their ability to access other forms of government support. The case should be considered in light of hardships experienced by other community members who may receive no extraordinary support." (p.18)

[10] For one illustration consider the ACT bushfires of the Australian 2003 summer, and an article highlighting the case for compulsory home insurance by Richard Holden and Andrew Leigh, available at http://www.smh.com.au/articles/2003/02/03/1044122319726.html, accessed April 30, 2016.

[11] There are, of course, many arguments for why governments may not act purely rationally. See, for instance, the classic work of James M. Buchanan and Gordon Tullock (1962). The Calculus of Consent: Logical Foundations of Constitutional Democracy. Yet "Public Choice Theory", which is considered by many to have been initiated by Buchanan and Tullock, suggests that government will cater to special interests such as taxi licence holders (see, for example, http://www.economics21.org/html/public-choice-legacy-gordon-tullock-1145.html, accessed April 30, 2016). If government often caters to special interests but still deems a policy change appropriate against those special interests then the benefits must exceed the costs by an even wider margin than a rational government would believe. Thus, the case for government paying compensation is stronger, a fortiori.

[12] See, Andrew Beer (2014). "Structural adjustment programmes and regional development in Australia," Local Economy 7. Available at http://www.regionalstudies.org/uploads/Andrew_Beer_PDF.pdf. Accessed May 1, 2016.

These programmes have been criticised by the Productivity Commission, as well as think tanks such as the Grattan Institute for a variety of reasons. As Beer (2014) puts it:

> Program objectives were not adequately defined at commencement, which in turn made the evaluation of outcomes difficult – if not impossible;
>
> There are direct and indirect costs arising from structural adjustment programs. Both adding to the costs of other, more viable, enterprises, communities and industries;
>
> Often such measures come at a high cost per job created (Daley and Lancy 2011);
>
> Assistance is often directed to industries and businesses on the verge of closure. Measures intended to prop up sectors or industries at risk are unlikely to be effective;
>
> Job seeking for displaced workers is best dealt with through existing social safety nets and programs, such as the Jobs Network and Centrelink.

Summing up, the Productivity Commission noted: "Assistance designed to 'buy-off' opposition to a policy change may appeal on pragmatic grounds. However, it is fraught with difficulties and carries considerable risks." (2001 p.xix)

One aspect of such programs which has largely escaped criticism is the source of compensation, should it be paid: namely, in that case, the Commonwealth government. For reasons similar to those mentioned above, since the policy (in this case trade policy) is made by government and the beneficiaries are a diffuse and dispersed set of individuals, it is sensible that compensation, in the event it is deemed appropriate, is paid by the government from consolidated revenue.

This conclusion is magnified by the fact that—notwithstanding whatever disclaimers they made—it was government that created and facilitated the market for licences. Whatever hardship may have arisen is largely—perhaps completely—due to the nature, or absence, of government regulation of the secondary market for licences.

Incentive effects of compensation

To the extent that compensation is paid to existing industry participants, and that compensation is paid by either customers or new entrants, there are important and deleterious incentive effects.

It is a basic premise of economic rationality that agents (including firms) are forward looking, in the sense that they anticipate future consequences when making current choices. For instance: individuals think about what wages they will subsequently receive when thinking about how much to invest in education; individuals think about resale value when considering a property purchase; parents think about how much use a child will get from a toy when considering a purchase; and firms think about future revenues when making investment decisions.

Closely related to the last example is the fact that firms consider the future revenue stream they will receive when making investments in innovation. These revenues are affected by market demand conditions, the actions of competitors, taxation rates, and the regulatory environment.

If firms who successfully innovate are forced to pay compensation to the owners of technology or competitors their innovation harms, then they will rationally engage in less innovation activity.

The Commonwealth Government has actively embraced an "innovation agenda", stating: "Innovation keeps us competitive. It keeps us at the cutting edge. It creates jobs. And it will keep our standard of living high."[13] Causing those who develop and implement innovation products and technologies to pay compensation precisely in the event where they are successful runs counter to this agenda.

Reduced innovation and market entry has a clear negative effect on consumers, through lower quality goods and services, and higher prices than would otherwise be the case. Reduced innovation also has negative effects on economic growth more broadly, with corresponding negative impacts on employment and government taxation revenue.

Legal basis for compensation

Australian governments that have issued perpetual or long-term licences have made it explicit that the value of those licences may vary over time and that compensation should not be expected under any circumstances.

[13] *See Australian Government (2016), http://www.innovation.gov.au/start/agenda?tid=1.*

For instance, NSW warns[14]:

> The value of a licence may vary over time due to a number of factors, including market demand, economic conditions and regulatory activity. Intending licensees contemplating acquiring a licence should seek independent advice on the suitability of the licence for the intending licensee's purposes.
>
> Transport for NSW makes no representation as to the future market value of any licence.
>
> Existing and prospective licensees are informed that in circumstances where the market value of a licence is impacted by the effects of regulatory reform or other factors, Transport for NSW cannot be held liable to pay any compensation to the licensee.

The Victorian TRANSPORT (COMPLIANCE AND MISCELLANEOUS) ACT 1983 - SECT 90 provides that:

> No compensation payable
> (1) No compensation shall be payable to any person in respect of or as a consequence of any decision or determination made pursuant to this Part—
>
> (a) to grant, issue, renew, reject, cancel, suspend or revoke any licence, certificate, permit, consent, assignment or other authority under this Part;
>
> (b) to add, alter or vary any condition or term of or attached to any licence, certificate, permit, consent, assignment or other authority under this Part; or...

The Tasmanian Act is even more succinct:

> TAXI AND HIRE VEHICLE INDUSTRIES ACT 2008 - SECT 88
>
> 88. Cancelled licence
>
> (1) The holder of a licence that has been cancelled by the Commission must deliver up that licence to the Commission at such time and place as the Commission may require.
>
> (2) The holder of a licence that is cancelled by the Commission is not entitled to any compensation for the cancellation of that licence.

Practicalities of compensation

A further issue with compensation is the administrative burden of collecting it, if it is to be paid by consumers. This issue was recently discussed in the Estimates Committee of the Western Australian Parliament, referring to the schemes used in New South Wales and South Australia[15]. An instructive quotation from that discussion is the following (emphasis added):

> **Mr D.C. NALDER:** We did look at the levy. New South Wales and South Australia are collecting $1 per fare, or that is what they have stated they will do. At this point, they have not worked out how they will do that. The ability to get the information to be able to collect it seems problematic. We are trying to keep the processes simple. That levy will flow through as an additional cost to customers. We could say it is only $1, but if a taxi driver has 10 fares a day, six days a week on average, **we are talking upwards of an extra $3 000 that they have to pay back to the government from what they collect from customers. The additional cost of the administrative process of trying to deliver the levy is where we think it starts to become problematic.** We are not necessarily opposed to trying to do it; it is just that there is not a simple way to implement it because we do not have accurate information; no-one does in any jurisdiction. We have not been able to get from New South Wales or South Australia exactly how they will implement the system at this point.

This administrative burden is a significant transaction cost which could, in principle, be larger than any benefit coming from the levy itself. That is, this means of compensation could actually leave the taxi industry worse off.

[14] *Transport for New South Wales, http://www.transport.nsw.gov.au/operators/taxis/taxi-licences (accessed May 2016).*

[15] *Parliament of Western Australia, see http://www.parliament.wa.gov.au/Hansard/hansard.nsf/0/7854167fa4feffb948257fc7002448ea/$FILE/A39+S1+2 0160524+p111c-121a.pdf (accessed June 1, 2016).*

Appropriate uses of levies

Notwithstanding the significant transaction costs associated with collecting and administering levies, there is also the question of the size of such a levy and what are appropriate/legitimate uses of those funds.

If the number of taxi licences licences issued in the future is lower, then governments may face reduced revenue from licensing and accreditation. The South Australian government has raised the possibility of using a levy both for compensation of licence holders and to offset the foregone government revenue from licensing and accreditation.[16]

The central purpose, and chief virtue, of a levy is that it is narrowly tailored and targeted to a particular behaviour or event.

Levies that are not narrowly tailored and designed for a specific purpose are simply taxes. Using a levy on users of transport services to fund foregone government revenue is economically equivalent to an additional sales tax on such services. This, like any such tax, distorts the market by creating a wedge between the marginal benefit to consumers of the service and the marginal cost to producers of providing the service.[17] This leads to lower consumption than is socially optimal, making society as a whole worse off.

Since any calculation of the magnitude of a levy required to pay compensation is inherently speculative (at a minimum it depends on the number of future rides undertaken by consumers), there is a significant risk that governments will use this lack of transparency to bolster general revenues, thereby leading to the negative consequences just mentioned.

Costs of delaying reforms

Delaying reform is detrimental to consumers and postpones the realisation of benefits arising from innovation and more efficient transport models.

These more efficient transport models provide lower cost and/or higher value services to consumers, and foster competition which causes existing services to improve their product offerings. An example of this is the increased availability of more sophisticated mobile phone applications for booking taxi services that include real time location data and the ability to communicate directly with the driver.

Moreover, lower cost and higher value services grow the market overall. Levies on new models, such as ridesharing, directly reduce the benefits just described.

Indeed, a $1 levy corresponds to an approximately 7-12% increase in the cost of ridesharing services—which is similar to the 10-15% electronic payment surcharge (e.g. Cabcharge).

Eliminating such surcharges has been an important and beneficial reform—including in New South Wales in 2014. To reduce (for instance, halve) the electronic payments surcharge, only to turn around and increase it is inconsistent, and poor policy that directly harms consumers.

The levy will harm drivers and operators too. A $1 levy would amount to a 4 per cent increase in the average NSW taxi fare.[18] Given established assumptions about the price elasticity of taxi demand in NSW,[19] a 4 per cent increase in fares would reduce taxi demand by 3.2 per cent. That is 3.2 per cent less work for drivers, who already earn an average of $10 per hour,[20] and 3.2 per cent less work for operators, the majority of whom are not licence holders.

Moreover, the appropriate way to think of the transport market is arguably more broadly, encompassing trains, buses and light rail, for instance. This raises the question of whether when light rail is constructed in Sydney's Eastern Suburbs, for example—as it is currently—taxis should be compensated for the increase in competition. It seems unlikely that such payments would ever be made, but raises the question of consistency, and singling out ridesharing services.

[16] Government of South Australia, http://www.premier.sa.gov.au/index.php/jay-weatherill-news-releases/381-state-government-to-reform-the-taxi-and-chauffeur-vehicle-industry

[17] See N. Gregory Mankiw (1998), Principles of Microeconomics. Dryden Press. Fort Worth, TX, p.156.

[18] Australian Taxi Industry Association (2014), state and territory statistics.

[19] IPART (2014), Guide to the taxi industry model.

[20] CIE (2014), survey of taxi drivers and operators.

Conclusion

The economic case for compensating existing perpetual licence holders is not strong.

Purchasers of perpetual licences:

(i) were heavily and explicitly warned about the possibility of a change to the licensing regime;

(ii) arguably received ex ante "compensation" through the market price of licences adjusting for policy risk, as has been documented in other asset markets;

(iii) with the exception of relatively recent purchases, received healthy internal rates of return on their investment, consistent with the notion that they have already earned an economically fair return;

(iv) are relatively unlikely to see their asset depreciate to zero or de minimis value because of the ongoing market demand for taxi travel—in part caused by ridesharing services expanding the market, and also because licences will continue to hold significant and protected value;

(v) will continue to be able to derive ongoing revenue from their licence owing to access to a protected rank and hail market; and

(vi) are often wealthy beyond the value of their licences, making the case for hardship-based payments limited to a small number of individuals who purchased their licence quite recently and who are individuals of modest means.

These factors strongly circumscribe the potential pool of licence holders who should plausibly be compensated.

Moreover, there are compelling arguments that any compensation paid to this pool of licence holders should be paid by the relevant government, from consolidated revenue, rather than through some kind of levy on consumers or from new market entrants.

The former both hurts consumers through higher prices and also imposes formidable logistical and implementation costs on drivers. The latter source of compensation discourages innovation, market entry, and competition—all of which have a deleterious effect on consumers and on overall social welfare more broadly.