Special Feature: Fare Play Required in Cab Wars

Geoff Riley (Eton College) examines recent proposals to deregulate the UK taxi market

Fare deal

In recent weeks I have had to make more journeys than normal using a taxi. The flexibility that a taxi service provides is often greatly valued, particularly when you are chasing to catch a train or get home late at night. Less appealing is the curse of sitting in the back of a cab watching the fare mount and wondering whether you have enough loose change to pay the fare!

Many of you will also have experienced the frustration of having to wait for a taxi to arrive, of queuing in a long line of people worse for wear looking for that elusive car to take you home. There seem to be plenty of taxis around, except when you need one – a version of Sod's law.

Taxis on tap

Are we about to see a huge **expansion** of the number of vehicles involved in the taxi industry in the UK? In March 2004, the **Office of Fair Trading** (OFT: www.oft.gov.uk) published a lengthy study into the UK taxi market. Their report suggested that **consumer welfare** could be improved by local authorities lifting limits on the number of taxis that can operate within defined areas and for councils to encourage greater **price competition** between taxi operators for fares below the maximum permitted rates.

Clearly the OFT has an agenda in such reports. Their main aim is to **protect the interests of consumers**. As their web site makes clear:

"The OFT is responsible for making markets work well for consumers. We achieve this by promoting and protecting consumer interests throughout the UK, while ensuring that businesses are fair and competitive."

The issue really is whether **deregulation** of the taxi industry will help to meet these aims. It is certainly a market that is well worth investigation by economists!

Big Business

Taxis are big business! Last year the private hire and taxi industry was worth **£2.6 billion**. Department of Transport statistics tell us that cab vehicle use currently average 12 trips per person per year and that the average length of a cab trip is 4.7 miles. 32 per cent of the public use a taxi at least once a month, compared to just 16 per cent in the mid-1980s. Taxis now account for about one per cent of all journeys made per year, equivalent to about 700 million separate fares covering around 3.5 billion miles.

Younger people are far more likely to make use of taxi services. Typically they make upwards of thirty trips per year. People without a car naturally rely more on local taxi services to get themselves around.

The average spending on taxi journeys increased by over 50 per cent in **real terms** between 1994 and 2001 and there are now over 75,000 licensed taxis and over 105,000 private hire vehicles operating in the UK. The industry employs over 160,000 people and demand for taxis and private hire vehicles has expanded by over 350 per cent over the last twenty-five years!

Segmented and regulated

Traditional **black cabs** (also known as Hackney Carriages) are able to take customers from the street without a prior booking. Mostly found in urban areas, black cabs are **highly regulated** by local authorities. **Private hire vehicles**, or **minicabs,** have to have a prior booking when picking up passengers and usually operate through radio link systems run by small businesses.

The taxi industry in the UK is one of the most highly regulated markets around, creating **barriers to the entry** of new taxi businesses. For example, of 354 local authorities in England, 45 per cent impose **quantity restrictions** on the number of licensed taxis. These **restrictions on supply** are most stringent in urban areas and what tends to happen is that where licensed taxis are in short supply there is a greater number of private hire vehicles (PHVs).

In 2003 for the UK there were 1.08 taxis per 1,000 of the

Sources: Office of Fair Trading; TGWU web site population and 1.46 private hire vehicles. In restricted areas, that number falls to 0.94 taxis per 1,000 of the population and 2.01 PHVs.

In most areas where supply restrictions apply, there are lengthy **waiting lists** for taxi licences, suggesting that there is a **pent up demand** amongst people wanting to operate taxi services. According to the OFT survey, the average waiting list is 78 people of whom over two-thirds already hold a taxi-drivers licence but who cannot operate in the market because they need a vehicle licence plate.

Naturally when **demand exceeds supply**, the market value of a licence plate can be quite high. In Nottingham where taxi demand is boosted by a high demand from students, people using bars and clubs, football supporters and rail travellers, a licence is estimated to be worth £50,000!

"In the know" about entry barriers

Local authorities can also restrict supply by introducing tests on **local geographical knowledge.** In London, all licensed taxi drivers are required to pass a knowledge test. In urban areas outside London that figure drops to 86 per cent among restricted areas and only 31 per cent in rural locations.

Other entry barriers include a **minimum wage** for drivers (typically 21) and the requirement for drivers to take a health check when they apply for a licence. Criminal records checks and up to date MOT certificates also apply. Only in a minority of areas do local authorities require purpose-built taxi vehicles and in some areas, authorities impose an upper age limit on the age of a taxi vehicle.

The biggest area of regulation is the fares that taxi firms can charge. Tariff 1 covers day time travel and Tariff 2 covers night time journeys. Across the UK there are relative few differences in average fare charges between urban and rural areas but there are differences of up to 20 per cent between areas where the number of taxis is deregulated (allowing a greater supply of vehicles) and in regulated areas. Night-time fares are higher – the average cost of a two mile journey in the UK is £3.80 for day-time travel and £5.00 for evening travel.

Case for and against deregulation

The Office of Fair Trading argues that lifting some of the restrictions on the number of taxi licences will give consumers a better deal. What are the main justifications for this? Essentially they relate to the wider benefits of opening up a market and making it more contestable. These benefits can be summarised as follows;

1. Lower prices:

Deliberately restricting supply creates a situation where taxi fares are artificially high requiring regulation in the form of maximum prices. In case studies of local authorities that have removed quantity restrictions, the supply of taxis increased on average by about 50 per cent. The benefits are greatest at peak times. Lower prices would cause an expansion of demand and a higher level of consumer surplus

2. Waiting times

The relative shortage of taxis leads to a rise in average waiting times and this creates a gap in the market which is partly filled by illegal cabs – 1.8 million people used an illegal taxi in 2002

3. External costs

There are social problems resulting from people queuing for taxis late at night for example through the risks of public disorder

4. Benefits to lower income households

More taxis on the streets will lead to lower prices. And lower-income households stand to gain most from this because studies show that people in the lowest 20 per cent of incomes use taxis and PHVs the most. Disabled groups may also see an improvement in their welfare if fares fall and more vehicles are fitted with facilities that given them access.

5. Tapping into a latent demand

The OFT believes that there is a high latent (potential) demand for taxi services that would best be served by opening up the market to increased supply.

6. Consumer choice

Increased competition would encourage taxi firms to compete on price and encourage consumers to shop around looking for the best deal – for example if there was more competitive between firms operating telephone and online booking services. Competition is seen as improving both allocative and dynamic efficiency in the market

All of this sounds plausible – but as always in economics, the debate is not settled, there are grounds for questioning the policy of liberalising local taxi markets and encouraging new firms to enter to provide taxi services to consumers. The possible downsides are summarised below:

Fares might rise!

Although more competition should bring fares down, if demand is not sufficiently high, then taxi occupancy rates will fall. Paradoxically this then puts upward pressure on taxi fares because car owners must make enough from journeys to cover their operating costs and earn a sufficient income

Customer confusion

Opening up the market could easily lead to greater customer confusion over fares and there is little evidence that consumers would be any likelier to haggle for lower fares if there was a wider choice in the market-place or at the taxi rank. Do we really expect consumers to hail a number of taxis before they get the price they want?

Fears over safety

Quality controls achieve through regulation are still needed to ensure that the safety of consumers is not compromised – for example a proliferation of unlicensed minicab firms operating in uninsured cars with poor reputations for customer safety

Cream-skimming

There is no guarantee that waiting times would fall for all consumers, particularly if new entrants to the market sought to cream-skim only the most profitable segments of the taxi market in a particular town or city

Congestion

If the supply of taxis increased would the space for them to operate also expand? A lack of available rank space could lead to greater congestion and potential conflict between drivers and customers! This was certainly the case in Liverpool which de-restricted the number of taxis operating in the city centre but moved to re-impose restrictions some months later

Barriers to entry work

Expensive licence premiums act as a barrier to entry – but they also act to deter unscrupulous private hire drivers who might have a damaging effect on the safety and accident records that the licensed taxi industry is proud of

It is certainly the view of the Licensed Taxi Drives Association that the government should tread carefully before encouraging further deregulation in the market. The Transport and General Workers Union which represents thousands of taxi drivers has been vehement in its opposition to taxi deregulation. According to their General Secretary, Mr Jack Dromy

"The people who know the industry best, the taxi drivers themselves, know deregulation cannot and will not work. We know from the bitter experience of the bus industry that many are now looking for a return to regulation not more competition."

But we should be aware that as one of the key **stakeholders** in the industry, they too have a vested interest in controlling the supply of vehicles to maintain the real incomes of existing taxi firms.

Likely outcome

The most likely outcome in the months and years ahead is a controlled expansion of the supply of taxi licences as demand in the industry continues to grow. Despite the strongly pro-competition leanings of the Office of Fair Trading, the government is keen avoid some of the problems that might come from allowing complete deregulation of the market.

The taxi industry makes an important contribution to our transport sector, it is hugely important for millions of people at the start and end of countless journeys and although we might often feel we are being ripped off by high taxi fares, the fact that more and more people are willing to make these journeys says something about our **revealed preferences** and the true value that the services give to us at different and often anti-social hours of the day and night!

Black cabs may need to revise their pricing if greater competition leads to an increase in supply