

Hon Tommy CHEUNG Yu-yan, GBS, JP  
Chairman of the Bills Committee on Franchised Taxi Services Bill  
Legislative Council  
Attn: Clerk to the Bills Committee

20 December 2019

Dear Mr Cheung,

### **Competition Commission's views on the Franchised Taxi Services Bill**

The Competition Commission (Commission) is pleased to submit its views on the Franchised Taxi Services Bill (Bill) to the Bills Committee. This is supplementary to the policy advice it offered to the Government earlier. With this letter, the Commission hopes to provide a succinct account of the Commission's views of Hong Kong's taxi services and practical recommendations for the Bills Committee's consideration. We attach more details of our views on specific provisions of the Bill in Annex A and of considerations for wider reform in Annex B.

### **Competition is needed for the advancement of Hong Kong's taxi service**

In its *2017 Public Transport Strategy Study*, the Government came to the conclusion that *"without reforming the existing regime of taxi services, it will be difficult to meet the community's demand for quality personalised and point-to-point public transport services."*<sup>1</sup> The Commission is convinced that one of the fundamental reasons that services are not meeting the community's demands is that **competition has been excluded from Hong Kong's taxi services because the industry has been strictly regulated by the Government despite rapid technological improvements and other changes over time**. Even if taxi drivers and licence holders have a genuine desire to improve the quality of their service – and many clearly do - there is very little of the market mechanism, if any, that rewards those that do or penalises those that do not.

For example, there have been criticisms about cash being the only payment method accepted by most licensed taxis, despite electronic payments being widely used in Hong Kong for many years (including for green minibuses and kaito). While a taxi owner might want to make payment more convenient for passengers – doing so will incur costs that may not necessarily result in more business. Taxi industry regulation

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<sup>1</sup> [Public Transport Strategy Study June 2017](#) paragraph 8.6. See also the Transport and Housing Bureau's brief to the Legislative Council on the Franchised Taxi Services Bill ([FTS Briefing Paper](#)) paragraph 2.

means that the flag fare is the same regardless,<sup>2</sup> and in addition individual taxis cannot easily differentiate their services from each other. For those who operate in a less regulated market, for example selling snacks in a small store, there is an incentive to make it easier for customers to pay. By investing in an Octopus card reader they might hope to win more business from a competing store which does not. Those competing stores in-turn are incentivized to make a similar investment. Over time this dynamic has resulted in customers having the option to use non-cash payments virtually everywhere. Competition, in this case, means that those sellers who provide a better service (including by making it easier for their customers to pay) do better than those that do not. This competitive dynamic does not currently exist amongst licensed taxis. There is therefore little incentive to innovate or improve. Although a number of licensed taxis have started to embrace e-payments and other innovations, progress has been slow. Other reasons may be given as to why e-payments have not been commonly accepted by most licensed taxis but by being insulated from market forces the industry has been allowed to stay still rather than improve to meet consumer's changing expectations.

The Commission appreciates that a pure market approach will not be appropriate in some circumstances. For example, where harmful side effects ("negative externalities" in economic terms), such as pollution or congestion, are experienced by society as a whole and the cost of which would not be properly accounted for if being left purely to market forces. There is therefore a role for regulation but such **regulation should be targeted to address specific concerns and not used to insulate an industry from innovation and advancement, nor should the regulatory regime "be tied down by certain trade interest."**<sup>3</sup> A key advantage of allowing competition rather than regulation to drive quality improvements is that it tends to provide improvements that are genuinely demanded by consumers. It may be the case that there is demand for USB charging facilities, WIFI and a 24-hour customer service hotline in 2019<sup>4</sup>, but it is less clear what will represent "high quality" in five-years' time.

In summary, the Commission agrees that the Government should address the *"strong and growing public demand to enhance personalised and point-to-point public transport services"*.<sup>5</sup> **However, the Commission is of the view that the Scheme, as currently proposed, may not be able to achieve that.** First, only about one in thirty taxis will be a franchised taxi and so the effect on the wider market will

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<sup>2</sup> The flag fare for all urban taxis is \$24, New Territories taxis at \$20.5 and Lantau taxis at \$19.

<sup>3</sup> LegCo Paper [CB\(4\)666/16-17\(05\)](#), paragraph 5

<sup>4</sup> Or in May 2016 when the telephone survey was conducted.

<sup>5</sup> FTS Briefing Paper, paragraph 2.

be limited. Second, the Scheme appears designed to minimize price competition between franchised taxis and existing taxis, and thus limits market forces.

As the Government points out, Hong Kong's "*personalized and point-to-point transport services must move forward*".<sup>6</sup> **The Commission believes that it is time for the Government to give serious consideration to wider reforms.**

In Annex B we set out academic and competition authority-generated literature and experience gained from other jurisdictions that have reformed their taxi markets.

### **Views on specific provisions of the Bill**

On top of the call for a broader, effective industry reform, the Commission puts forward a number of observations and practical recommendations specific to the Bill. The two most significant recommendations are: (a) Setting the flag fare via a competitive process; and (b) Setting the number of franchised taxis at a level that meets the community's demand. These are discussed below alongside an explanation why pro-competitive reforms will benefit drivers as well as passengers. In Annex A, the Commission provides further details on these and further recommendations, for example on the need for the Government to properly understand the effects of allowing "tipping".

#### **(a) Setting the flag fare via a competitive process**

The Government proposes a \$36 flag fare for franchised taxis. This is 50% above existing taxi flag fare. The justification given is "*to set a clear fare differential between ordinary taxis and franchised taxis to achieve a more distinctive market positioning.*"<sup>7</sup> As noted above, the Commission does not doubt that there is demand for higher quality taxi services, and notes that the Scheme already requires franchisees to meet high quality standards that exceed those of licensed taxis.<sup>8</sup> This is the basis on which the new services should be differentiated. Common sense would suggest that even if people are willing to pay a \$36 flag fare for a higher quality service, they would prefer, and be better off, paying less. **It is counterintuitive that a rational consumer would demand to pay more.**<sup>9</sup> **The level at**

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<sup>6</sup> LegCo Paper [CB\(4\)666/16-17\(05\)](#), paragraph 5

<sup>7</sup> FTS Brief Paper, paragraph 12.

<sup>8</sup> See paragraph 10-13 of Annex A. in relation to those quality standards.

<sup>9</sup> There is a category of goods called "Veblen" goods where demand increases as price increases – but these are luxury goods which act as a status symbol and therefore have no application to public transport policy.

**which the flag fare is set appears to intentionally *reduce* competition on price between franchised taxis and licensed taxis.**

The result of setting fares to avoid competition between the different types of taxis is not only that users will pay more for franchised taxis than they otherwise would, but also **the likelihood of the Scheme improving the quality of licensed taxis will, by design, be greatly diminished.** By contrast, adopting a market mechanism for fare setting would likely result in lower fares at similar levels of quality. This is obviously a benefit to passengers of franchised taxis and may, particularly if the proportion of franchised taxis increases, improve licensed taxi services whose operators will feel competitive pressure to improve quality. **If a similarly high quality taxi service can be provided at a lower fare, there is no public interest in the Government requiring a higher fare to be set.**

In brief, the Government should use the tender process to require bidders to compete to offer the lowest fares while also taking into account service quality. This can still be subject to tendering rules that mandate minimum quality standards and maximum fare levels. The Government should take into account the interests of consumers who should have access to a high quality taxi service set at the lowest possible price. In Annex A, the Commission sets out some detailed suggestions on how this can be achieved.<sup>10</sup>

**(b) Setting the number of franchised taxis at a level that meets the community's demand**

If franchised taxis are able to provide a higher quality of service with fares set at market prices (rather than being fixed by the Government) then they are more likely to be used by the public. In such circumstances, there are good reasons why the total number of such vehicles should be increased to reflect demand.

The Government justifies the small number of franchised taxis by highlighting it is a trial scheme.<sup>11</sup> The purpose of any trial should be to assess whether the number of franchised taxis is appropriate and the Commission feels that setting a statutorily

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<sup>10</sup> See paragraphs 10 to 13.

<sup>11</sup> Paragraph 7 of the FTS Briefing Paper.

defined number at the outset is not the right approach. The figure ought to be reassessed within a shorter period of time, for example two years.<sup>12</sup>

The Government indicates that at the end of the trial period it *“will thoroughly consult various stakeholders, including the taxi trade, before proceeding with the required legislative amendment exercise.”*<sup>13</sup> While consultation is necessary, it can be assumed that if the Scheme introduces more competition to licensed taxis, further expansion will be resisted by those license holders. For that reason, the Government should commit to **assessing the Scheme on the basis of the extent to which it *“meets the community’s demand for personalized and point-to-point public transport services of higher quality.”*<sup>14</sup> and whether it *“drives the ordinary taxi trade to improve their service quality”*.<sup>15</sup>**

### **Taking taxi drivers’ welfare into consideration**

There has been, understandably, concern raised about the welfare and livelihood of drivers for both franchised and licensed taxis. The Government has sought to address this by encouraging franchisees to employ drivers.<sup>16</sup>

Increasing the number of franchised taxis and, even better, introducing a wider industry reform should give existing taxi drivers more, and possibly better, alternatives to renting a licensed taxi. Reforms that result in an attractive alternative for drivers that rent taxis strengthen drivers’ ability to negotiate with licensed taxi owners.

Also, if licensed taxi services are being used less frequently, the primary impact will be on license holders rather than non-licence holding drivers. The cost of renting a taxi licence should, absent some anti-competitive constraint, reduce to reflect demand. If driving a licensed taxi becomes less profitable, and alternatives, such as becoming an employed franchised taxi driver, more attractive, licensed taxi owners will need to offer more attractive terms and lower rents to attract drivers.

In addition to lowering rents, licensed taxis owners may also need to respond by improving service quality – for example introducing new payment methods, upgrading their vehicles, wider adoption of satellite navigation etc. Alternatively, they may consider it necessary to propose lowering fares or at least hold them

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<sup>12</sup> This would not require the franchise period to be two years as new franchises could be introduced before the expiry of existing franchises particularly if this possibility was made clear in advance of the tendering of the first franchises.

<sup>13</sup> FTS Briefing Paper, paragraph 7.

<sup>14</sup> FTS Briefing Paper, paragraph 3.

<sup>15</sup> FTS Briefing Paper, Annex G, paragraph 5.

<sup>16</sup> FTS Briefing Paper, paragraph 9.

steady. This would clearly benefit passengers as well as drivers.

### **Conclusion**

The Commission is concerned that the Scheme as currently proposed may not be able to achieve its stated policy objectives. The best way of improving the quality of taxis and other similar services is by allowing a greater role for competition. While some regulation is necessary, it should be designed to benefit the community. It should not be used to protect certain trade interests who will naturally prefer to be protected from competition which the current Scheme seems to have the effect of doing so.

As indicated in the earlier advisory note, the Commission would be glad to work with the Government to consider further changes to allow the community and consumers to obtain the full benefit of competition in the provision of taxi services.

Yours sincerely,  
Competition Commission

## Annex A: Views on specific provisions of the Bill

1. The focus of the Commission's submission in this annex is how the Bill can be amended to allow for greater levels of competition, particularly in relation to price. The stated purpose of the FTS Scheme (Scheme) is to improve taxi services in general but the Commission has concerns that the way in which the scheme is designed may reduce rather than optimise competition.
2. This part is structured as four key issues:
  - a) the manner in which fares are set;
  - b) the number of franchised taxis and length of the trial period;
  - c) tipping; and
  - d) other considerations.

### a) Manner in which fares are set

*Are franchised taxis intended to compete with licensed taxis?*

3. The FTS Briefing Paper identifies the current situation in which *"the quality of existing taxi service is largely dependent on the Government's education/publicity efforts and the self-discipline and performance of individual owners or drivers"* as being *"unsatisfactory"*.<sup>1</sup> The Scheme is intended to *"enhance personalized and point-to-point public transport services"*<sup>2</sup> but this comes at a price of fares being fixed at 50% above ordinary taxi fares regardless of the cost to provide the service. This is explained as being necessary *"to set a clear fare differential between ordinary taxis and franchised taxis to achieve a more distinctive market positioning"*.<sup>3</sup>
4. The FTS proposal appears to intentionally **reduce** competition between franchised taxis and licensed taxis. While the Commission does not doubt that there is demand for higher quality taxi services, the FTS proposal already requires franchisees to meet high quality standards that exceed those of licensed taxis.<sup>4</sup> This is the basis on which the services should be differentiated. Common sense would suggest that even if people are willing to pay a \$36 flag fare for a higher quality service, they would

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<sup>1</sup> Paragraph 3 FTS Briefing Paper.

<sup>2</sup> Paragraph 2 "Justification" FTS Briefing Paper.

<sup>3</sup> Paragraph 12 FTS Brief Paper.

<sup>4</sup> See paragraph 39 in relation to those quality standards.

prefer, and be better off, paying less. Indeed, it is counterintuitive that any rational consumers would demand to pay more.<sup>5</sup>

5. The result of this is not only that users will pay more for franchised taxis than they otherwise would, but also that the likelihood of the FTS scheme putting competitive pressure on, and thereby improving the quality of, licensed taxis will be diminished *by design*.
6. The basis on which the Commission believes that fares set using a competitive process would be lower is provided at paragraph 7. Paragraph 8 provides a response to the Government's explanation for not adopting a competitive process to set fares and sets out some ideas on how such a process might work. At paragraph 14, we highlight possible impacts of lower fares<sup>6</sup>. Paragraph 20 explains how the Bill could be amended to take account of the Commission's proposal.

#### *Why setting a \$36 flag fare is likely to cost passengers more*

7. The Commission has four grounds to believe that using a competitive process to set the franchised taxi fares would result in lower fares – without diminishing quality.
  - a) First, if those bidding to be awarded a franchise calculated that a HK\$36 flag fare was insufficient to cover costs and produce an acceptable profit, they would not bid. It would only be if the Government was able to perfectly assess the cost of providing franchised taxi services and that cost was the same for all possible providers that they could set a fare equivalent to that set by the market. This is unrealistic.
  - b) Second, the Bill makes provision for a franchise service fee (see clause 7) to be paid by the franchisee. The assumption that bidders will be able to pay a franchise fee indicates that absent the fee they would have been able to provide the services for less. Particularly as they will have to be sufficiently confident of the profitability of charging a \$36 flag fee to pay the franchise fee upfront.
  - c) Third, the FTS Briefing Paper does not indicate the \$36 flag fare to be based on a detailed assessment of costs. Rather it appears to be an amount that a sufficiently small proportion of those surveyed would be willing to spend on taxi services.

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<sup>5</sup> There is a category of goods called "Veblen" goods where demand increases as price increases – but these are luxury goods which act as a status symbol and therefore have no application to public transport policy.

<sup>6</sup> Albeit the small total number of franchised taxis would significantly undermine this effect for which see from paragraph 21.



- d) Fourth, the flag fare is proposed to be tied to the licensed taxi fare. There is no reason to assume that an increase in licensed fares should result in franchised taxi service providers' costs increasing.

*The Government's concerns with allowing a competitive process to set fares*

8. In its earlier advisory note, the Commission has raised the manner in which the flag fare is set with the Government. The Government responded in the FTS Briefing paper by highlighting "*the need to provide adequate and reasonable incentives for the operators to maintain higher quality of services in a sustained manner which would require higher operating costs*".<sup>7</sup> The Commission has four points in response to this:
- a) It does not address the assumption that far from simply covering a tenderer's operational costs, the HK\$36 flag fare will also result in tenderers offering a franchise fee.
  - b) It ignores the fact that if the fares were to be set on the basis of a competitive process, no prospective franchisee would bid at a level which would not take into account their *actual* operating costs.
  - c) The Government has not provided any details of its assessment of what these higher operating costs are.
  - d) It implies that simply charging more in itself will lead to higher quality of service. There is no reason why this should be the case.
9. The Government in response to the Commission's earlier advice highlights two concerns with using a competitive process to set fares:
- a) a clear scale of fares charged according to taximeter is one of the key components of taxi service; and
  - b) allowing individual franchisees to charge different fares would change fundamentally the nature of franchised taxi service.
10. The Commission does not believe that using a competitive process to set fares is inconsistent with there being a clear scale of fares charged according to a taximeter.
11. If there were to be a single franchise taxi provider, it would be straightforward to set fares on the basis of the lowest bid. Alternatively, if the Government allowed franchise holders to offer different starting fares potentially with the same increment, this would be straightforward. Each franchise could use its brand name to indicate to customers its positioning in the market.

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<sup>7</sup> FTS Briefing Paper Annex G paragraph 6

12. If, however, the Government wants there to be multiple providers charging the same fare then there are several ways this could be achieved through a tender process which maintains price competition.

a) There could be a two stage process to select the desired number of franchisees. For example, assume that the desired number of franchisees is three, as proposed by the Government. In the first stage, the quality aspects of the proposed franchisees would be assessed, and those bidders who meet a certain quality level, for example six bidders, will proceed to the second stage. The second stage would then be a reverse auction where the flag fare to be set would be reduced in incremental steps. Franchisees would stop bidding at a flag fare at which they would be unwilling to provide the service. If more than three franchisees are willing to offer services at \$36 flag fare, the proposed rate would drop, for example, to \$34. The price will be set at the point where there will be three bidders left in the auction.

b) As with (a) except the stages would be the other way around so that the reverse auction would set the fare and then say five remaining bidders would compete in a second stage on the basis of quality. This option would have the benefit of allowing a full assessment of price and quality but may result in a higher flag fare than (a), (albeit lower than that set without any regard to competition).

13. These are of course only suggestions and the design of such a process would require more detailed consideration. The key points are that using a competitive market based approach to set the fare is not inconsistent with having a clear scale of fares that applies to all franchisees and quality of service will also be considered.

#### *Impact of a market based pricing mechanism*

14. For reasons outlined in paragraph 7 above, adopting a market mechanism would likely result in lower fares for similar levels of quality. This is obviously a benefit to passengers of franchised taxis and may, particularly if the proportion of franchised taxis increases, improve licensed taxi services.

15. There has been, understandably, concern raised about the welfare of drivers. Provisions can be included in the tender exercise to encourage franchise holders to treat their drivers fairly. This would be assessed as part of the “quality” aspect of the bid.

16. This however does not address the issue of the welfare of licensed taxi drivers. If those seeking to use a taxi service have a chance to use a high quality, competitively

priced, franchised service, they may reduce the use of licensed taxi services and it will be harder for licensed taxi drivers to find fares.

17. One answer to this is that the impact of the Scheme will be severely constrained by the limited number of franchised taxis but this is not a complete answer given our proposal to increase that number or at least shorten the trial period (see from paragraph 21 below).
18. A better answer is that if licensed taxi services are being used less frequently, the primary impact will be on license holders rather than non-licence holding drivers. The cost of renting a taxi licence should, absent some anti-competitive constraint, reduce to reflect demand. If driving a licensed taxi becomes less profitable, and alternatives, such as becoming an employed franchised taxi driver, become more attractive, licence holders will need to offer more attractive terms and lower rents to attract drivers for licenced taxis. Any difficulty for licence holders to attract drivers indicates a failure to respond to competitive market conditions.
19. Licensed taxis could also respond to the competition introduced by franchised taxis. They may do this by improving quality – for example increasing use of other payment methods, updating their vehicles, wider adoption of satellite navigation etc. Alternatively, they may consider it necessary to propose lowering fares or at least hold them steady. This would clearly benefit passengers while again putting downward pressure on the value of a taxi licence.

*Taking account of the Commission's proposal*

20. Adopting the Commission's proposed change would not require any significant amendments to the Bill. The fares are set out in the schedule and would simply need to be amended to reflect the outcome of the competitive process.

**b) Number of franchised taxis and length of the trial period**

21. If franchised taxis are able to provide a higher quality of service with fares set at market prices (rather than being fixed by the Government) then they are likely to be more readily accepted by the public. In such circumstances, there are good reasons why the total number of such vehicles should be increased to reflect demand.

22. The Government justifies the low number of franchised taxis by highlighting it is a trial scheme.<sup>8</sup> The comparison with the statutory cap that applies to public light buses is therefore inapt, public light buses are well established and not part of a trial scheme. The purpose of any trial should be to assess whether the number of franchised taxis is appropriate and it is arguably unnecessary and premature for it to be a statutorily defined number.
23. If part of a trial scheme, starting with a small number (e.g. 600) franchised taxis may be appropriate but this figure ought to be reassessed within a much shorter period of time. Possibly two years.<sup>9</sup> For the avoidance of doubt, this would not require the franchise length to be shortened.
24. Paragraph 8 of the FTS Briefing Paper states that the Government “*will thoroughly consult various stakeholders, including the taxi trade, before proceeding with the required legislative amendment exercise.*” While consultation is necessary, it can be assumed that if the Scheme introduces more competition to licensed taxis, further expansion will be resisted by the taxi trade. The Government should commit to assessing the Scheme on the basis of the extent to which it “*meets the community’s demand for personalized and point-to-point public transport services of higher quality.*”<sup>10</sup> and whether it “*drives the ordinary taxi trade to improve their service quality.*”<sup>11</sup>

**c) “Tipping”**

25. The Commission has previously raised concern about the acceptance of “tipping” to “facilitate the matching process”. This concern has not been addressed and runs counter to the Government’s view that “*a clear scale of fares charged according to taximeter is one of the key components of taxi services.*”
26. A tip is a sum of money given as a reward for a service. This is not what is envisaged here as the “tip” will be required to be offered as part of the matching process in advance of any service being provided. In effect, at peak times customers will need to offer an additional, uncertain, sum to use a franchised taxi. One of the core reasons why taxi regulation was introduced was to prevent over-charging and passengers being taken advantage of when demand for taxis spiked. Allowing “tipping” undermines this. While passengers will, technically, not be charged more,

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<sup>8</sup> Paragraph 7 of the FTS Briefing Paper.

<sup>9</sup> This would not require the franchise period to be two years as new franchises could be introduced before the expiry of existing franchises particularly if this possibility was made clear in advance of the tendering of the first franchises.

<sup>10</sup> Paragraph 3 of the FTS Briefing Paper.

<sup>11</sup> Paragraph 5 Annex G of the FTS Briefing Paper.

they are likely to be denied service unless they pay more. It will also presumably make it harder to hail a franchised taxi as franchisees (and if incentivized – drivers) will prefer passengers that use an app which can offer a “tip” in advance.

27. The harm of allowing tipping is greater than surge pricing.
  - a. Surge pricing allows for a potential increase in supply to meet demand. Supply of franchised taxis will be fixed.
  - b. Where there are several apps, even where demand is high and surge pricing is used, there will be some competitive pressure.
  - c. Desperate customers will not know how much to “tip” in order to attract a taxi – they will ultimately have to offer more than would otherwise be acceptable to the driver/franchisee in order to get a taxi.
28. While surge pricing is often justified on the basis of bringing capacity into the market, it is not clear what justification the Government has in allowing “tips”. The total number of franchised taxis will be constrained and franchisees should be either incentivized or required to offer an appropriate level of service throughout the day.
29. In addition, because the Government does not appear to assess the impact of “tips” as part of the tender exercise, a franchise bidder may offer a comparable level of quality and a higher franchise fee on the basis that it will seek to recover more through consistently requiring substantial “tips” before customers will be able to use their services. As it is not assessed, each bidder’s incentive will be to take advantage of it.<sup>12</sup>
30. This issue would similarly arise if fares were set through a competitive process. Bidders could bid at low flag fares on the basis that they would demand large “tips” before providing a service.

#### *Taking account of the Commission’s proposal*

31. The franchised taxi providers could be permitted to accept genuine tips but restricted from allowing tips having a role in the matching process.
32. Alternatively, if the role of tips in the matching process is to be retained, the Government should make provision for it in the tender exercise. Either imposing a cap or requiring bidders to specify the maximum income they or their drivers will derive from tips and including that level as part of the Government’s assessment.

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<sup>12</sup> See FTS Briefing Paper Annex D

33. In addition, franchise holders could also be required to ensure a minimum number of taxis are providing services during peak times reducing the necessity of tips.

**d) Other considerations**

34. The Commission has a number of concerns with the FTS proposal that it wishes to bring to the Bills Committee's attention, even though it is not clear that they could be addressed through amendment.

*End of franchise arrangements*

35. The Commission has raised concerns in the past about Government's contracts with franchisees that allow the first franchisee such an entrenched status that once the franchise period ends there is no further real possibility of competition.<sup>13</sup> For example, Hong Kong franchised bus network has not been subject to any open competition since 1995.<sup>14</sup>

36. Unless the Government plans for how they can run a genuinely competitive re-tendering process at the outset, there is a danger that the first franchisees will become the permanent franchisees and similarly immune from any future competition as licensed taxis.

37. Relevant considerations include how the service is marketed, ownership of essential assets, employment of staff, co-operation in handing over to a new franchisee etc. While a matter of details, early consideration of these matters can have a dramatic effect on the competitive pressure franchisees are subject to.

*Capital requirements*

38. Setting the minimum capital requirement at \$50 million appears high and would reduce the pool of eligible tenderers.

*Quality requirements*

39. A key advantage of allowing competition, rather than regulation, to drive quality improvements is that it tends to provide improvements that are demanded by consumers. It may be that there is demand for USB charging facilities, WIFI and a 24-hour customer service hotline, but it is not clear from the FTS Briefing Paper what

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<sup>13</sup> 31 October 2018

<sup>14</sup> Report prepared by Mr Mike Weston for the Independent Review Committee on Hong Kong's Franchised Bus Service

evidence the Government have that this is the case. It is even less clear what will represent “high quality” by the expiry of the franchise term in five years.

40. The Government similarly did not explain the requirement for a 24-hour manned customer service hotline. Such a service is likely to be expensive and offer limited customer benefit over a service hotline that has extended, but not 24 hours, operating hours. It also prevents the opportunity for bidders to provide more innovative digital solutions which may offer similar customer benefits at lower costs.
41. As well as requiring quality improvements which will increase costs and may not be demanded by passengers, the Government did not require a range of vehicle sizes. There is almost certainly demand for a taxi service that is able to accommodate a larger number of passengers (at an increased fee).

## Annex B: Wider Reforms

1. This Annex considers alternatives to the FTS scheme which aims at allowing consumers to obtain the full benefit of competition. The FTS Briefing Paper acknowledges the potential need to “*explore introducing other new services*” in the event that the FTS scheme fails to serve its purpose.<sup>1</sup> The Commission considers that exploration should begin without delay and that it has a role to play to ensure such reforms fully harness the power of competition to meet the demands of the public.
2. This is a topic on which there is a sizeable volume of studies from academics and competition authorities as well as examples of reforms from other jurisdictions. Some key points in relation to both are set out below.

### A. Academic and Competition Authority Studies

3. There have been numerous academic studies together with opinions by antitrust agencies which support the idea that the introduction of alternatives to traditional taxi services brings about many benefits to consumers through enhanced competition on the point to point public transport service market. The 2018 OECD report [Taxi, ride-sourcing and ride-sharing services](#) provides a useful summary (**OECD Report**).<sup>2</sup>
4. Much of the academic research has been focused on understanding benefits of ride sourcing and ride sharing services (collectively referred to as “e-hailing services”) which might explain their successful introduction in numerous jurisdictions. These have looked at price, availability, quality and safety.
5. There have also been several studies that have looked at concerns about reforms that open up regulated taxi markets to e-hailing services.

### Factors which might explain the successful introduction of alternatives to regulated taxis

#### *Price*

6. E-hailing services operate outside the pricing mechanisms applicable to taxis and therefore able to compete on prices, through various formulas, and offer more certainty to consumers through a prior estimate of the cost of their ride. Section 1.3.1 of the OECD Report identify the following jurisdictions in which ride hailing services

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<sup>1</sup> [FTS Briefing Paper](#) paragraph 25.

<sup>2</sup> *Taxi, ride-sourcing and ride-sharing services - Background Note* by the OECD Secretariat, 30 April 2018 ([https://one.oecd.org/document/DAF/COMP/WP2\(2018\)1/en/pdf](https://one.oecd.org/document/DAF/COMP/WP2(2018)1/en/pdf))



are cheaper than taxi services: Stockholm, Ottawa, Toronto, Jakarta, Mumbai, Amsterdam, Sydney, Melbourne, Brisbane, Perth. This in turn may put pressure on taxi service providers to agree to reduce their regulated fares.<sup>3</sup>

7. It may be that in certain jurisdictions e-hailing services are similarly priced to traditional taxi services or more expensive. But given transparent pricing, consumers who pay more to use an e-hailing service must have some justifications to do so, such as factors related to availability, quality or safety.

#### *Availability*

8. The introduction of e-hailing services expands the number of service providers and, provides allocative efficiency by optimizing the matching of supply and demand.<sup>4</sup> This is important as while increasing the number of cars may add to congestion, increasing efficiency reduces waiting times and benefits consumers without negative side effects.<sup>5</sup>
9. A study of taxi services in New York showed that neighbourhoods least served by other forms of public transport suffered from similarly low taxi coverage. Taxi drivers lacked information about real-time demand. Ride-sharing services were able to use matching technology to fill this gap and mitigate long-standing geographical disparity in transportation.<sup>6</sup>

#### *Quality and Safety*

10. E-hailing service providers are also more able to develop different products and services based on particular quality features (e.g., car model and condition) or business model.<sup>7</sup> Riders can also benefit from greater convenience attached to the booking process itself: securing the ride early on to avoid refusal to hire, cashless payment, GPS tracking that avoids complaints on the route taken by the driver, multilingual features to ease the transaction with foreigners.

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<sup>3</sup> In 2015, base fare of Toronto taxi was reduced by 1 Canadian dollar in order to enable them to compete against Uber, [www.thestar.com/news/gta/2015/11/01/toronto-taxi-base-fares-drop-by-1.html](http://www.thestar.com/news/gta/2015/11/01/toronto-taxi-base-fares-drop-by-1.html) . As Gett broke the monopoly in the Ben-Gurion International Airport in Tel Aviv, taxi fares dropped by 31%, [www.haaretz.com/israel-news/business/taxi-fares-from-ben-gurion-airport-to-be-cut-by31-1.5472922](http://www.haaretz.com/israel-news/business/taxi-fares-from-ben-gurion-airport-to-be-cut-by31-1.5472922) .

<sup>4</sup> According to a study by Crammer, J. and A. Kruger Uber drivers have higher capacity utilization rate than taxi drivers ("*Disruptive Changes in Taxi Business: The Case of Uber*" *American Economic Review*, Vol. 105/5, pp. 177-182).

<sup>5</sup> The OECD Report at paragraph 34 highlights academic studies that show in Toronto, Ottawa and New South Wales waiting times for a ride sourcing company were shorter than for traditional taxis. And a separate academic study that seemed to show shorter waiting times due to dynamic pricing and the digital booking process generate additional consumer welfare.

<sup>6</sup> Lam, Chungsang and Liu, Meng, *Toward Inclusive Mobility: Ridesharing Mitigates Geographical Disparity in Transportation* (Jan 9, 2019). Available at SSRN: <http://dx.doi.org/10.2139/ssrn.2997190>

<sup>7</sup> See section 1.2.1 of the OECD Report.

11. The perception in most (but not all) jurisdictions is that the reputation system used by e-hailing services often works better than traditional taxi regulation to improve the quality of services.<sup>8</sup> For example, a study of the Indian taxi market presented by an Indian consumer organization found that just 8% of respondents thought the behaviour of regulated taxi drivers was “good” and 37% described them as “bad”.
12. There is some evidence that the introduction of competing e-hailing services increased the quality of regulated taxis. There has been a decrease in complaints related to taxi services in New York since the introduction of e-hailing services. This benefits consumers who still only use taxis.<sup>9</sup>
13. In some jurisdictions, for example Mexico and the Philippines, e-hailing services provide more robust vetting of drivers than the regulated taxi market.<sup>10</sup> This is less likely to be a benefit to consumers in Hong Kong given the background checks required to be a taxi driver.

### Concerns about reforms that open up regulated taxi markets to e-hailing services

#### *Congestion*

14. A concern about congestion being a barrier to wider reforms is alluded to by the Government in its view that adopting the Scheme in place of other reforms means that *“the impact on the road traffic is also easier to anticipate.”*<sup>11</sup> The OECD Report notes that one of the most cited arguments for quantitative restrictions on taxis is preventing congestion and pollution. In relation to pollution, account needs to be taken of the cars used, for example, the environmental impact of a Toyota Crown Comfort is greater than a Toyota Prius. In terms of congestion, academic studies have suggested that imposing fees based on congestion or pollution is more effective than a quantitative cap.<sup>12</sup>

#### *Safeguard of taxi driver and taxi licence holder welfare*

15. It is evident, and understandable, that the Government are concerned about the impact of any pro-competition reforms on the existing taxi industry. The issue of taxi

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<sup>8</sup> ITF (2017), *Shaping the relationship between public transport and innovative mobility*, <https://www.itf-oecd.org/shaping-relationship-between-public-transport-and-innovativemobility>. See page 24.

<sup>9</sup> Wallsten, S. (2015), *The Competitive Effects of the Sharing Economy: How is Uber Changing Taxis?*, [https://www.ftc.gov/system/files/documents/public\\_comments/2015/06/01912-96334.pdf](https://www.ftc.gov/system/files/documents/public_comments/2015/06/01912-96334.pdf).

<sup>10</sup> ITF (2017), *Shaping the relationship between public transport and innovative mobility*, <https://www.itf-oecd.org/shaping-relationship-between-public-transport-and-innovativemobility>. See page 20.

<sup>11</sup> *FTS Briefing Paper* paragraph 25.

<sup>12</sup> Scheller, B. (2017), *“Unsustainable? The Growth of App-Based Ride Services and Traffic, Travel and the Future of New York City”*, <http://schellerconsult.com/rideservices/unsustainable.pdf> page 20. .

driver welfare has been addressed in the letter. In relation to the welfare of taxi licence holders the OECD Report states:

In addition, for those taxi drivers who own their licence, it may be that they invested in the licence as an asset by which to save for retirement (since it can be sold when exiting the market). With regard to this point, it is not clear why this particular form of speculative retirement saving scheme requires protection while other savings vehicles do not (ITF, 2016, p. 24[2]). Similar to licences as retirement savings, it is not justified why taxi services market requires special protection from economic fluctuations.<sup>13</sup>

16. The Commission does not adopt this view but considers that the welfare of taxi licence holders needs to be balanced against the benefits brought by reforms to the wider community and consumers that allow more competition into the market, including through e-hailing services.

## **B. Examples of reforms adopted in other jurisdictions**

17. There is a consistent view across the academic literature and the approach adopted by competition authorities that reforms to taxi regulation that allow new operators (particularly those offering e-hailing services) provide important benefits to consumers.<sup>14</sup> There is much more diversity of views as to the kinds of reforms the Government should promote. Authorities in different jurisdictions have responded in a variety of ways and these responses (and their outcome) provide a useful guide which can inform a reassessment of Hong Kong's regulatory regime.
18. Set out below are three examples of reforms. These range from complete liberalisation adopted in Finland, to much more limited reforms adopted in France. The example of New South Wales in Australia shows a more balanced approach which includes financial support for participants in the traditional taxi industry.
19. The Commission would be happy to do further research on the approaches adopted in these and other jurisdictions (and their impact) and how they may be adjusted for Hong Kong, if considered beneficial.

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<sup>13</sup> OECD Report paragraph 58.

<sup>14</sup> Ibid paragraph 161.

*Full liberalization of the point to point transport service market: the case of Finland*

20. A reform of point to point transport service was recently carried out in Finland. The Act on Transport Services<sup>15</sup> that entered into force in July 2018 has brought about a massive change toward the liberalization of this sector.

- Taxi quotas were abandoned
- The pricing regulation, consisting in a decree setting maximum fares, was abandoned. Taxis can apply various fares and pricing models – a fixed fare for certain routes, a pricing model based on duration, distance, zones, time (surge price), and etc. The total price or basis for calculating the prices must be provided in a clear and unambiguous manner ahead of the ride.
- Any operator that meets the requirements to obtain a licence as per the terms of the Act can operate a taxi; anyone with a driver's licence and no serious criminal record who passes a driving test which no longer requires local knowledge may become a taxi driver.
- Any three- or four-wheeled vehicle (except buses) can operate as a taxi; the sign on the roof of the vehicle is no longer compulsory; the vehicle has to be registered as a taxi.
- Geographical restrictions were abandoned.

21. Since the Act came into force, several e-hailing services that either are new to the Finnish market or had to exit due to the previous regulation of the sector have launched their services (Estonian Taxify, US Uber, Russian Yandex etc.).

22. The deregulation is too recent to have a definite view of its impact, however there are first indications that prices initially dropped but have since increased albeit remaining lower than prices before the reform.

*An approximation of the conditions of operation among point to point transport service providers: the case of New South Wales (NSW)*

23. A new regulation of point to point transport service (the Point to Point Transport (Taxis and Hire Vehicles) Act 2016)<sup>16</sup> came into force in November 2017. Its aim was to open up the taxi market to new service providers while safeguarding the interests of the taxi profession.

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<sup>15</sup> <https://www.lvm.fi/lvm-site62-mahti-portlet/download?did=246709>

<sup>16</sup> <https://www.legislation.nsw.gov.au/acts/2016-34.pdf>

24. Two categories of service providers are recognized under the new law: taxis and booking service providers, i.e., e-hailing service providers are legalized. The key features are:

- Only taxis can provide rides initiated through street hail or taxi rank.
  - The maximum fare charged for a taxi ride is set by a government regulation. Each taxi provider must publish its own fare structure, setting out the fares it will charge, below that regulated maximum fare. Full information on fares must be displayed in the taxi. A fare calculation device such as a meter must still be used.
  - The number of taxi licences remains regulated. Each year, a number of taxi licences to be released is set by government. As a transition, the government announced in late 2015 that no new taxi licence other than wheelchair accessible taxi licences and replacement licences would be issued in Sydney for at least four years.
- Taxis as well as e-hailing service providers can offer pre-booked rides (online or over the phone) as booking service providers.
  - The fares for booked services are deregulated. Booking service providers must provide an upfront fare estimate, based on a rate per hour, a rate per distance, a flat rate, or a combination of those, and must indicate any variation in the fare that is likely to occur and the way in which the variation is to be calculated. A ride can only start once the passenger has accepted the fare estimate.
  - The number of booking services providers is not regulated. Booking service providers other than taxis have to register and apply for an authorization – no test is to be taken.
- The NSW Government established an industry adjustment assistance package of up to \$250 million to ease the transition into the new regulatory framework.
  - Funding has been made available across three schemes: up to \$98 million for transitional assistance for eligible taxi licence holders and taxi training schools, up to \$10 million for an additional assistance scheme for eligible hire car licence holders, and up to \$142 million for a further additional assistance scheme, targeting those detrimentally impacted by the point to point transport reforms and in financial hardship.
  - In order to fund the assistance package, a Passenger Service Levy of \$1 is payable by all point to point transport service providers for every passenger

ride. The levy will be in place for no more than five years, or until it raises the full amount required to fund the assistance package – whichever comes first.

*A controlled opening up of the market for point to point transport services: the case of France*

25. A law of October 2014<sup>17</sup> has sought to define the perimeter of the taxi profession and of the e-hailing point to point transport service providers. It was supplemented with a law of 29 December 2016 and secondary legislation. The taxi profession, however, remains tightly regulated.

26. Taxi providers must hold a licence, which is obtained for free from the government or can be acquired from a retiring taxi provider. In Paris, the average waiting time to obtain a licence for free is 14 years, and the price of a licence in early 2019 was about 115,000 euros. However, the licences granted since the 2014 law came into effect are non-transferrable. In addition

- Taxi providers must also pass an exam that includes written and practical tests.
- There is a geographical restriction on the area where a taxi provider can offer rides.
- Only taxi providers can offer rides initiated by street hail or from a taxi rank. They can also offer pre-booked rides.
- Fares for all taxi rides, whether street hailed, from a taxi rank or pre-booked, are regulated by local government, and calculated through a combination of time and distance through the use of a meter.

27. E-hailing service providers are legal and are also regulated.

- While there is no restriction on supply, e-hailing service providers now have to take the same exam as the taxi profession, which in effect limits their number.
- They are not subject to a geographical restriction but are meant to drive back to their base (i.e., their place of establishment) after the end of a ride, except if another ride had been booked already.
- They can offer only pre-booked rides.
- Fares for e-hailing services are unregulated; fares can either be a flat fare determined upfront or a fare calculated on the basis of the duration and distance of the journey once the ride is completed.

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<sup>17</sup> [https://www.legifrance.gouv.fr/jo\\_pdf.do?id=JORFTEXT000029527162](https://www.legifrance.gouv.fr/jo_pdf.do?id=JORFTEXT000029527162)